

Telephone: 020 7066 9346

Email: enquiries@fs-cp.org.uk

27 September 2022

queries-cp22-15@fca.org.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to the FCA consultation on calculating redress for non-compliant pension transfer advice

The Panel welcomes the opportunity to respond to the FCA's consultation on calculating redress for non-compliant pension transfer advice.

The Panel has a longstanding interest in this issue, having provided early warnings to the FCA in relation to the BSPS in consultation responses and meetings dating back to 2018. At the time, the Panel urged a proactive regulatory approach in light of concerns about the potential for unsuitable advice in this market. Four years on from these warnings, many BSPS members have suffered significant detriment. The regulated advice market, intended to be a key protection against financial loss, failed to protect consumers, with 47% of advice deemed to be unsuitable.

The Panel believe that any proposals and their outcome(s) should be consistent with the new Consumer Duty and invite the FCA to explore and explain how these rules fit with the Consumer Duty.

In this context, it is particularly important that redress now be accessible to consumers in a fair, consistent, and understandable way.

Our responses to the questions posed in the consultation are included at Annex A below.

Yours sincerely

Helen Charlton

Chair, Financial Services Consumer Panel

Annex A

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

Yes. We agree with the FCA's assessment that consolidation will make the rules simpler for firms to follow and will support assertive supervision and enforcement action.

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?

Yes, the Panel agree.

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, the Panel agree. We believe it is an important principle that redress should, as far as possible, seek to offset the detriment suffered by the consumer in question. We recognise that a lump sum might be the most practicable way to achieve this, so long as, to the extent possible, this is paid into a DC scheme and not distributed as cash, in line with the FCA's wider proposals. We recognise that consumers might nonetheless later make use of pension freedoms to withdraw money from a DC scheme as a cash lump sum, but this is beyond the scope of the compensation mechanism. The Panel note that the proposed rule does not prevent firms from buying the customer an annuity matching the benefits of their DB scheme if the firm and the customer are willing to do this to settle their case.

See further our responses to Q10 and Q45-48

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, the Panel agree.

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, the Panel agree. This would support consistency of redress and simplify calculations for consumers.

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?

Yes, the Panel agree.

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

Yes, the Panel agree. This is an important additional protection to ensure the robustness and consistency of calculations.

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

Yes, the Panel agree. However, firms should be flexible and consider all information provided where this could be relevant to the judgments being made. The Panel believe there is some wording missing under 'information about the consumer's former DB scheme' (which only refers to 'Section').

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?

Yes, the Panel agree. In recognition of the inevitable complexity of information requests, we recommend that consumers also be reminded of the value of seeking advice from outside bodies, whether paid for advice obtained through the commercial sector or free advice through bodies such as the Money and Pensions Service.

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

Yes, the Panel agree. It is central to the principle of redress that the consumer be returned as close as possible to the position they would have been in had they not suffered the detriment in question. If unsuitable advice led to wider losses, these should therefore be considered as part of redress, even if they sit outside the redress calculation methodology. This would fall in line with the requirements of the new Consumer Duty. As a principle, consumers should also be compensated for 'distress and inconvenience', as determined by the specific circumstances of the policyholder, the extent of inconvenience suffered by them, and the duration of the inconvenience. The Pensions Ombudsman provides guidance¹ for claims of 'maladministration' which may be relevant.

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, the Panel agree. We also agree with the FCA's decision to diverge from Deloitte's advice and consider more frequent review based on key trigger events.

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?

Yes, the Panel agree.

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

¹ https://www.pensions-ombudsman.org.uk/sites/default/files/publication/files/Updated-Non-financial-injustice-September-2018-2_0.pdf

proposed changes to improve consistency of redress calculations? If not, which alternative approach would you propose?

Yes, the Panel agree, but see also our response to Q15.

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

Yes, the Panel agree, but see also our response to Q15.

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?

The Panel are mindful of the cliff-edge that is introduced by hinging the formula on before- and after-2030, rather than taking a more graduated approach. We are also mindful of the turbulent environment with respect to inflation; in July 2022, for example, there was a 2.2 percentage point gap between RPI and CPI inflation. We would suggest at minimum that the FCA keep this element of the approach under more regular review to avoid the risk of systematic under-compensation of consumers, or indeed of over-compensation putting firms at risk. If evidence emerged that the approach to inflation is no longer reliable this should be considered an adequate trigger event.

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?

It is true that the UK has suffered historically low growth in real earnings since 2008. However, care should be taken before locking in a more conservative assumption for future real earnings growth. Real earnings growth had been recovering into 2021 before the recent spike in inflation. The Panel therefore recommends exercising caution and at minimum keeping assumptions for future earnings growth under regular review to ensure consumers are not systematically under-compensated. We recognise that a balance needs to be struck, so that consumers are not systematically better than they would have been in the original DB scheme.

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

See answer to Q16 as above.

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?

The Panel agrees in principle with adopting an approach that takes account of inflation's potential volatility, although the Panel has no comment on the appropriateness or otherwise of the Black-Scholes model.

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, the Panel agree.

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

No comment.

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?

No comment.

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, the Panel agree. It is important not to overcomplicate the approach and since there are a wide range of approaches to lifestyling, assuming no lifestyling allowance seems pragmatic and fair.

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, the Panel agree there is no need to specify an alternative pre-retirement discount rate in these circumstances. However, the rules should stipulate that in these circumstances firms must seek to address those circumstances in a way which is consistent with the rules and guidance so as to put the consumer, as far as possible, in the position they would have been if they had received compliant DB pension transfer advice.

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?

No comment.

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?

No comment.

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?

No comment

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

We would encourage the FCA to test the assumptions that sit behind this approach. The approach is based on the fact that "most DB scheme members take a tax-free PCLS that is close to the maximum entitlement". However, the FCA argues elsewhere in the consultation document that people who left DB schemes based on poor advice are less risk-taking than the average consumer. Is it fair to assume that this group of low-risk-appetite consumers behave similarly to 'most' consumers when it comes to lump sums?

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, the Panel agree.

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

Yes, the Panel agree.

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, the Panel agree and believe this will give more consistent and robust estimates.

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, although the Panel recommends that the FCA first evaluate any differential impact on men and women from this proposal due to differences in the average age of men and women in heterosexual couples.

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?

While the underlying presumption of retirement at no earlier than NRA (para 6.9) is reasonable, the Panel would propose broadening the factors to be taken into account to rebut the presumption. Para 6.14 lists "key factors" to be taken into account. The Panel is concerned that firms could limit their considerations and base their assessment only on these "key factors". It would be fairer (and, we believe, consistent with the Consumer Duty) for the rules to stipulate that firms take into account the customer's circumstances, and their reasons for any drawdown from the DC pension. These should include, but not be limited to, the factors in 6.14.

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?

Yes, the Panel agree. The Panel would emphasise that it is important that the figures used reflect the FCA's best estimate of the product and advice fees consumers actually pay, and not the fees that consumers could pay if they secured the best rates in the market.

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?

Yes, the Panel agrees it is important to offset the cost of initial advice charges. As above, this should reflect estimates of actual fees consumers pay, not what they could pay on securing a good deal.

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?

The Panel is concerned at the prospect of assuming that consumers will pay no more than £3,000 for advice in light of statistics shared in the consultation that estimate the mean average initial advice fee at £2,808. If the FCA therefore believes that a meaningful proportion of consumers pay more than £3,000 for initial advice, this could merit assuming a higher maximum charge in the calculation of compensation. The Panel notes also that assumed advice charges are based on the FAMR (pre-pandemic and prior to significant increases in the cost of living). We would invite the FCA to consider an uplift in assumed advice charges, to ensure fair recompense to consumers.

See further our response to Q51 which would suggest an increase for further advice costs is needed.

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

Yes, the Panel agree.

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

The Panel has concerns about this approach. If the Panel understands correctly, the proposal is to adjust compensation for the value of cash enhancement payments by assuming that these payments were invested at the time and secured a standard rate of return. If this is the case, the Panel would be concerned that this could lead to under-compensating consumers who in practice will have been unlikely to invest cash enhancement payments.

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?

No comment.

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, the Panel agree.

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, the Panel agree.

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.

The Panel does not have a view on the details of the approach but endorses the need to identify cases in which GMP is likely to be material.

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?

Yes, the Panel agree.

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, the Panel agree.

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, agreed.

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, the Panel agree. It is particularly important that payments be directed into the consumer's DC pension by augmentation wherever possible. Compensation should be aiming for an outcome in which the consumer receives a retirement income equivalent to the income they would have received had they not been the victim of detrimental advice. We believe directing payments into a DC scheme by augmentation is the best way to achieve this.

We believe the rules could go further to mitigate the risk that consumers err towards taking lump sum cash payments. We worry that, particularly given wider pressures on the cost of living, consumers might be more likely to take a cash lump sum and use this to cope with immediate pressures, causing themselves significant long-term financial detriment and leaving themselves without adequate plans for retirement. The Panel suggests that the FCA consider further steps, such as the use of defaults and more clearly worded warnings to minimise the number of consumers who in practice take a lump sum as cash.

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?

The Panel is mindful of the risk that, under this approach, the annual allowance could push some consumers into receiving compensation in cash as opposed to via

augmentation. This could leave the consumer in a worse financial position, through no fault of their own, simply because compensation is paid in one tranche and is therefore subject to the annual allowance. The Panel suggests that the FCA consider the extent of this problem - for example by understanding how many consumers are likely to receive compensation that exceeds annual allowance rules - and consider alternative approaches if a meaningful number of consumers are affected.

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, the Panel agree.

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, the Panel agree. The Panel notes that firms should make consumers aware of this risk.

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, the Panel agree.

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, the Panel agree.

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, the Panel agree. However, the Panel sees it as highly unlikely that consumers will be in a position to "check the accuracy of their calculation and obtain fairer redress." It is unrealistic to think that, as per paragraph 7.30, consumers will have the confidence and understanding they need in order to assess the accuracy of a compensation calculation, even with full information. Outside advice will be important and other means of checking the accuracy of calculation could be merited, including the requirement of actuarial oversight and potentially wider research.

This speaks to the importance of recognising additional costs for 'outside advice'. If consumers face costs for advice in order to understand and navigate the compensation calculation, this is an additional detriment that flows from the non-compliant advice they originally received and acted upon. These costs should therefore be recoverable.

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?

It is vital that this wording be tested with consumers as consumer understanding of information provided to them is an important feature of the Consumer Duty. The assumption should be that consumers will find the complexity of these calculations overwhelming and will disengage or make decisions that are not in their financial

interest. It should not be assumed that on such a complex issue, consumers themselves can provide a line of defence against inaccurate or unfair calculations. Testing the wording of warnings with consumers directly is the only way to understand reliably how they will be received and is in line with the new Consumer Duty.

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, the Panel agree.

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, the Panel agree.

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, the Panel agree.

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, the Panel agree.

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, the Panel agree.

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, the Panel agree.

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, we recommend taking the approach as outlined in Q58 above, basing the calculation on the higher amount. This will limit cases in which consumers are under-compensated, thereby reducing the risk of further consumer detriment.

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, the Panel agree. Please also see answer to Q59.

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, the Panel agree. Firms should also ensure that this information is used only for the purposes of calculating redress and be clear to consumers that this is the case.

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, the Panel agree.

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, the Panel agree.

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, the Panel agree.

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

Yes, the Panel agree. However, more opportunities should be taken to encourage the consumer to seek relevant outside advice.

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

Yes, the Panel agree.

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.

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

Yes, the Panel agree.

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

No. The FCA should consider whether access should be expanded to third parties, subject to the necessary consumer consents, for example agencies supporting consumers through the journey and/or providing advice.

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

Yes, the Panel agree.

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

No comment.

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

No comment.

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

The calculator should be developed in line with the Government's service standard for the development of user-centred digital products.

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

No comment.