Financial Conduct Authority

Guidance consultation

GC17/1 – Changes to the way firms calculate redress for unsuitable defined benefit pension transfers

March 2017

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Abbreviations used in this document

BoE	Bank of England
CBA	cost benefit analysis
COBS	Conduct of Business sourcebook
CPI	Consumer Price Index
CMI	continuous mortality investigation
DB	defined benefit
DISP	Dispute Resolution: Complaints Sourcebook
ETV	enhanced transfer value
FAMR	Financial Advice Market Review
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSAVC	free-standing additional voluntary contribution
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
FTSE	Financial Times Stock Exchange
LRRA	Legislative and Regulatory Reform Act 2006
ONS	Office for National Statistics
p.a.	per annum
PIA	Personal Investment Authority
PP	personal pension
PPF	Pension Protection Fund
PRB	Pension Review Bulletin
PwC	PricewaterhouseCoopers LLP
RPI	Retail Price Index
SAPS	self-administered pension scheme
SIB	Securities and Investments Board
SMPI	Statutory Money Purchase Illustration
TVA	Transfer value analysis

1 Overview

Introduction

1.1 On 3 August 2016, we announced our intention to consult on updating the methodology used to calculate the levels of redress due in cases of unsuitable advice on transfers from defined benefit (DB) pension schemes to personal pensions.

1.2 We appointed PricewaterhouseCoopers LLP (PwC) to provide a review of the existing methodology, and provide recommendations for a new methodology. PwC's report is published separately on our website.[1]

1.3 We have considered PwC's recommendations. This guidance consultation paper explains how we have used PwC's recommendations in forming our proposals to update the current redress methodology so that consumers are more likely to be able to reproduce the benefits that they held in their DB pension scheme. We are asking for your views on these proposals.

Who does this consultation affect?

1.4 This consultation affects:

- consumers who were given unsuitable advice to transfer out of a DB pension scheme to a personal pension, and who have not yet accepted redress on a full and final settlement basis,
- firms that provide advice on transfers from DB pension schemes to personal pensions,
- software providers for these calculations, and
- professional indemnity insurers

Who is this paper relevant to?

1.5 This paper is relevant to consumers who were given unsuitable advice to transfer out of a DB pension scheme but have not yet accepted compensation. Our proposals update the redress methodology that firms are required to use to reflect the current pension environment, including changes to the level of risk of DB pension schemes and gender-neutral annuity rates. This paper addresses technical changes based on actuarial analysis, which we recognise may be difficult to follow. The proposed changes may result

[1] https://www.fca.org.uk/publication/research/pwc-new-redress-methodology-pensions-transfer-advice-cases.pdf

in increased redress payable in the situation outlined above however this is dependent on individual circumstances.

Context

1.6 The Securities and Investments Board (SIB) and the Personal Investment Authority (PIA) first introduced a pension redress methodology in the mid-1990s, as part of the 'Pensions Review'.[2] The aim of this methodology was 'to offer recompense to investors who [had] been disadvantaged as a result of bad advice and to put them into the position they would [have been in] if they had not suffered actionable loss as a result of a compliance fault'.[3]

1.7 The redress methodology was amended during the course of the Pensions Review along with the actuarial assumptions underpinning it. The Financial Services Authority (FSA) took on the Pensions Review in 2001. It maintained the methodology until 2004 when the Pensions Review drew to a close and announced that it did not plan to review it after this. Since that time, the Financial Ombudsman Service and the Financial Services Compensation Scheme (FSCS) have agreed that the redress methodology should continue to be used as the usual method to calculate compensation for complaints falling outside the Pensions Review. They have also made arrangements for the assumptions behind the methodology to be regularly updated.

1.8 Since 2004 there have been a number of significant changes to the pensions landscape, including the introduction of 'pensions freedoms'. Through our ongoing supervisory work we have recognised that there may be more appropriate ways to calculate redress for consumers who receive unsuitable advice to transfer out of a DB pension scheme. Given this and our wider pensions work, we have decided to review the methodology. No one single factor has caused us to look again at the methodology, but taken together we believed it was appropriate to examine the methodology again on a forward-looking basis.

1.9 The aim of redress in mis-selling cases is to put consumers into the position they would now be in had it not been for the mis-sale. We are conscious of the need to avoid retrospective regulation by applying a more demanding standard or interpretation of the rules after the event, with the benefit of hindsight, but do not consider that updating this methodology involves retrospective regulation. This is because we are seeking to replicate the benefits of a DB scheme in payments made today, where we can see more clearly what a consumer gave up.

1.10 In cases where there is an actual loss (e.g. where the consumer has already retired) this is a relatively straightforward exercise which involves comparing the pension that the consumer would have received under the DB pension had there been no mis-selling with what the consumer is in fact receiving under the personal pension. Where the loss is prospective (e.g. the consumer has not yet retired), the consumer's loss must be

[2] The industry review of contracts or policies established under the terms of the Statement of Policy on 'Pension transfers and Opt-outs' issued by the SIB on 25 October 1994.
[3] SIB Guidance Reports and Reviews – 'Pension Transfers and Opt Outs: Review of Past Business (Part 1:Statement of Policy) (October 1994)

calculated using assumptions that are based on current circumstances and estimates as to what the position will likely be in the future.

1.11 As explained further below, our proposals take into account changes to the pensions environment since the Pensions Review and are more likely to put consumers back into the position that they would have been in if they had not been given unsuitable advice to transfer out of their DB pension scheme. We propose that the revised methodology will apply only to complaints received by firms on or after 3 August 2016 (see paragraph 1.1) or complaints which had been received but not settled on a full and final basis by that date. The revised methodology would also not apply to cases falling within the scope of the Pensions Review or the free-standing additional voluntary contributions (FSAVC) Review.[4]

1.12 Our proposals improve the likelihood of consumers being able to reproduce the benefits that they would have held if they had not been given unsuitable advice to transfer out of their DB scheme. In this way, they help advance our objective of securing an appropriate degree of protection for consumers.

1.13 These proposals are not a shift in policy for us. The objective remains of allowing consumers to reproduce the benefits they would have held if they had not been given unsuitable advice to transfer out of a defined benefit scheme. However, we acknowledge this is a shift in a long-standing methodology. We also discuss in this paper options for keeping this methodology regularly updated.

Summary of our proposals

1.14 We propose to update the current redress methodology, including the underlying assumptions, so that it takes account of changes to the pensions environment and is more likely to put consumers back into the position that they would have been in if they had not been given unsuitable advice to transfer out of their DB pension scheme. This includes:

- updating the inflation rates used to better reflect likely inflation
- acknowledging the Pension Protection Fund (PPF) in updating the pre-retirement discount rate
- updating the post retirement discount rate, and acknowledging the likelihood that consumers will take a pension commencement lump sum updating the mortality assumptions
- making allowance for gender-neutral annuity rates
- assuming that male and female consumers are the same age as their spouse

[4] The industry review of contracts or policies established under the terms of the policy statement for the review of specific categories of FSAVC business, issued by the FSA on 28 February 2000.

- simplifying the assumption about the proportion of people who are married or in a civil partnership at retirement
- making allowance for enhanced transfer values (ETVs)
- updating these assumptions on a regular basis to reflect the fact that markets are often volatile

1.15 The redress calculation includes valuing future cashflows and so involves a number of assumptions on future unknown events. We recognise that we could have chosen from a range of possible assumptions, many of which PwC has addressed in its report. We explain why we have chosen our final options in the rest of the paper. Taken together, we consider that the assumptions we have used will deliver an appropriate level of redress.

1.16 The redress calculations need to be relatively simple using factors which are transparent and readily available. This means that our assumptions are approximate for all consumers rather than specific to individual circumstances. Aside from the assumptions, the methodology requires specific information about individual consumers to complete the redress calculation, such as number of years until their retirement. As a result of this, there may be some individuals who end up in a relatively better or worse position compared to others although we expect the majority to be in a better position. We welcome comments on our overall approach to assumption setting, as well as on the individual assumptions themselves.

Equality and diversity considerations

1.17 We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and other prohibited conduct, and to advance equality of opportunity and foster good relations between people who share relevant protected characteristics and those who do not.

1.18 We have considered the equality and diversity issues that may arise from the proposals in this paper. Our proposals will result in consumers being treated equally by requiring annuities to be calculated on a gender-neutral basis, irrespective of sex, sexual orientation and gender reassignment. While the effect of this may appear to reduce redress paid to women compared to what they would have received under the current methodology, this change simply reflects the change in annuity rates across the market as gender specific annuities can no longer be bought. Otherwise female consumers would receive more redress than they would need to buy an annuity whilst male consumers would receive less. Our proposals also assume that where a consumer is married or in a civil partnership, their spouse is the same age. This assumption is made regardless of the gender of the consumer or their spouse, or whether either had gender reassignment. Having a standardised approach simplifies the calculation and so allows firms to pay redress more quickly. Additionally, using this gender-neutral approach means that firms do not have to obtain additional personal data from the consumer.

1.19 Overall, we consider our proposals are consistent with eliminating discrimination, harassment, victimisation and other prohibited conduct, advancing equality of opportunity, and fostering good relations between people who share relevant protected characteristics and those who do not.

1.20 We will continue to consider the equality and diversity implications of our proposals during the consultation period. We will revisit them before publishing our response to the consultation and making any final guidance.

1.21 In the meantime, we would welcome your views on these issues.

Next steps

What do you need to do next?

1.22 This consultation is open for three months until 10 June 2017. Please provide any comments and/or evidence on our proposals by this date.

1.23 Please respond using the online response form on our website, or by sending your response by email to gc17-01@fca.org.uk or by post to Racquel Thomas-Smith, Policy Division, Strategy and Competition, The Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London, E14 5HS.

1.24 When responding, please state whether you are doing so as an individual or on behalf of an organisation. Please include your contact details with your response, so that we can contact you for more details on the issues you raise if necessary.

1.25 We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We cannot regard a standard confidentiality statement in an email message as a request for non-disclosure.

1.26 Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

1.27 All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 0790 or email publications_graphics@fca.org.uk or write to Editorial and Digital Department, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

1.28 Consumers who are unhappy with the advice they received to transfer out of their DB pension scheme may continue to complain to firms and to the Financial Ombudsman Service if they are not satisfied with the firm's response. If the firm is unlikely or unable to pay redress, consumers may make a claim against the firm to the FSCS. Where redress is due, a complaint should not be settled on a 'full and final' basis until the outcome of this consultation is known.

What will we do?

1.29 We will carefully consider your feedback to this consultation and issue a response in autumn 2017.

2 Background

2.1 This chapter explains the background to the current pension transfer redress methodology, and our reasons for reviewing it.

2.2 The current methodology that the industry uses to calculate redress where consumers have received unsuitable advice to transfer from a DB pension scheme to a personal pension is based on the methodology originally developed by the SIB and the PIA for the Pensions Review. The Pensions Review followed concerns that some consumers had been given unsuitable advice, and it applied to pension transfers, opt outs[5] and non-joiners.[6] It was carried out between 1994 and 2004 and required firms to review pension transfers they sold between 1988 and 1994. The objective of the redress methodology was to 'offer recompense to investors who [had] been disadvantaged as a result of bad advice and to put them into the position they would [have been in] if they had not suffered actionable loss as a result of a compliance fault'.[7]

2.3 The methodology calculates redress as the difference between the value of benefits a consumer would have received if they had not transferred out of their DB pension scheme and the value of savings in their personal pension. Where a consumer has not yet retired, it uses assumptions about the return on investments, inflation, mortality and expenses to calculate the value of benefits they would have received. However, if a consumer has retired or died a calculation can be made based on actual loss.

2.4 The FSA published assumptions on a quarterly basis up until February 2003. It then stated that it would update the assumptions annually rather than quarterly from April 2003. The FSA published annual assumptions in April 2003 in Pensions Review Bulletin (PRB) 24.[8] Having considered the small volume of outstanding Pensions Review cases and the costs and benefits of updating the assumptions, it announced in August 2004[9] that firms should use these assumptions in the future, regardless of the date of settlement. The FSA stated that keeping the assumptions fixed would ensure that an individual's redress would be the same as it would have been if the review had been completed near March 2003, when all Pensions Review cases should have been completed.

2.5 Some cases fell outside the Pensions Review because, for example, the relevant advice was given after 30 June 1994. For these cases, the FSA 'recognised that firms will continue to refer to the Pensions Review assumptions and method as a benchmark. A firm must, however, satisfy itself, in line with normal complaints procedures and bearing in mind that the assumptions have been kept fixed, that the calculation of loss and

[5] Opt outs – these complaints relate to consumers who were already members of an occupational pension scheme but left.
[6] Non-joiners – these complaints relate to consumers who were eligible to join occupational pension arrangements but did not join.
[7] SIB Guidance Reports and Reviews – 'Pension Transfers and Opt Outs: Review of Past Business (Part 1:Statement of Policy) (October 1994)
[8] http://www.fsa.gov.uk/pubs/pensions/prb24.pdf
[9] http://www.fsa.gov.uk/pubs/pensions/prb27.pdf

redress is appropriate to the individual's particular circumstances. It must not rely on the pensions review provisions as justification in themselves for its approach'.[10]

2.6 The Financial Ombudsman Service, in consultation with the FSCS and two industry experts, decided to continue to use the Pensions Review redress methodology for calculating compensation in pension transfer complaints falling outside of the scope of the Pensions Review where appropriate. It commissioned PwC to update the assumptions for the methodology every year, starting in October 2005.

2.7 PwC has since provided the assumptions to the Financial Ombudsman Service annually. In its more recent reports to the Financial Ombudsman Service, PwC stated that it did 'not expect the assumptions we recommend will generally correspond with those that might be adopted by insurance companies for pricing annuities' and 'we expect that the cost of purchasing an annuity from an insurer will exceed the capitalised value of the annuity payments'. PwC's letters to the Financial Ombudsman Service, which explain the assumptions and express concerns, are published on the Financial Ombudsman Service's website.[11]

2.8 Our ongoing supervisory work has revealed that there may be more appropriate ways to calculate redress to make it more likely that consumers are put back into the position that they would have been in, had they not been given unsuitable advice to transfer out of their DB pension scheme. As a result, we decided to review the methodology. We appointed PwC to provide recommendations for a new methodology. This report can be found on our website. We have considered PwC's recommendations, and we are now consulting on changes to the methodology and assumptions.

2.9 Our proposals are set out in the next chapter, and we have considered the following:

- **Gender-neutral annuity rates** – The effect of a judgment of the Court of Justice of the European Union was that insurers cannot make differentiations between men and women when determining premiums and benefits under insurance policies.[12] The market now applies unisex pricing for insurance, including annuities.

- **ETVs** – In July 2014 we published[13] the results of a review that considered financial advice given to consumers who were offered an ETV as an incentive to transfer out of their DB pension scheme. The review included nearly 300 cases and found unacceptable disclosure in 74% of cases and unsuitable advice in 34% of cases.

- **PPF** – The PPF was set up by the Pensions Act 2004 to provide compensation to members of eligible DB pension schemes if their employer becomes insolvent and the scheme has insufficient assets to pay its members' pensions. The PPF may pay 100% compensation to members who have reached their scheme's normal

[10] http://www.fsa.gov.uk/pubs/pensions/prb27.pdf
[11] http://www.financial-ombudsman.org.uk/publications/guidance/pension_assumptions.htm
[12] Judgment of the Court of 1 March 2011, Association Belge des Consommateurs Test-Achats ASBL and Others v Conseil des ministers (Test-Achats case) (Case C-236/09)
[13] https://www.fca.org.uk/news/press-releases/fca-publishes-results-thematic-reviews-enhanced-transfer-values-and-sipp

pension age or who have retired on grounds of ill-health. It may pay up to 90% compensation to members who have not yet retired or who have retired but have not reached their scheme's pensionable age, but this is subject to a retirement age dependent cap which is recalculated every year.[14] For example, from 1 April 2017 the cap for retirement at 65 will be £38,505.61 per year.[15] The existence of the PPF has reduced the level of risk that previously existed with DB pension schemes.

- **Pension freedoms** – In April 2015 the Government introduced pension freedoms, giving consumers with a personal pension greater choice in how they access their pension savings. We analysed the data we have collected since the introduction of the pension freedoms and found that many people are taking their pension pot as cash or choosing drawdown products instead of choosing an annuity. We are also aware that annuity providers are now using different pricing models, and that the implementation of Solvency II will have had an impact.

No single factor has caused us to look again at the methodology, but taken together we believed it was appropriate to examine the methodology again on a forward-looking basis.

[14]A full list of this year's compensation caps for each retirement age is available on the PPF's website: http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/Compensation_Cap_factors_April_2017.pdf
[15] This is subject to Parliamentary approval

3 Proposals

Overall approach

3.1 This chapter sets out our proposals for the methodology that firms should use to calculate appropriate redress following unsuitable advice to transfer out of a DB pension scheme.

3.2 We initially considered the overall approach to take so that consumers are more likely to be put back into the position they would have been in had they not received the unsuitable advice. This resulted in the following options:

- Reinstatement into the original DB pension scheme.
- Require the firm to purchase a deferred annuity for the consumer to match the pension that would have been received from the DB pension scheme.
- Require the firm to provide a guarantee to the consumer to match the pension that would have been received from the DB pension scheme once the consumer reaches retirement.
- Calculate the value of the DB pension scheme and personal pension benefits at a specified calculation date and compare these two values to determine the level of redress due. This is the approach of the Pensions Review methodology.

3.3 Reinstatement would give absolute certainty that the consumer has been put back into the position they would have been in. However, many DB pension schemes are either closed to new members or unwilling to agree to reinstate benefits. Some schemes may also no longer be in existence having wound up. For this reason, we do not consider that it would be an option for the majority of consumers.

3.4 Buying a deferred annuity would remove the investment risk from the consumer and ensure that they receive benefits at retirement that match the DB pension scheme they left. Additionally, if the annuity provider were to become insolvent and unable to meet its liabilities, these would be met by the FSCS. However, there may be a significant period of time between the calculation date and the consumer’s retirement date. As the investment risk would have been transferred to the annuity provider, the provider would be likely to charge a high premium as they would want to use low-risk investments to ensure there are sufficient funds through retirement to pay the pension payments as they fall due. This would be likely to result in a very significant increase in the redress costs for firms, if indeed annuity providers were willing to offer the deferred annuity in the first place. We believe that this cost would be disproportionate, as individuals took some risk on their pension scheme being unable to meet its obligations, although this risk is reduced by the PPF.

3.5 Providing a guarantee would ensure that the consumer receives benefits at retirement that match their DB pension scheme. However, it would also introduce additional uncertainty as the results would depend on the firm continuing to trade until the consumer's retirement date. For some firms in this market it would not be possible to be certain about this.

3.6 The final option, to compare the present value of the DB pension scheme benefits and the consumer's personal pension, was the approach taken in the Pensions Review. This is our proposed approach to calculating redress, as it results in: (i) an immediate settlement of the complaint for the consumer; and (ii) potentially the least delay to settling these complaints because it follows the existing approach. However, we believe we need to reconsider the methodology previously used in this approach in line with the changes set out in the rest of this chapter.

Q1: Do you agree with our proposal for the basis of the redress calculation methodology? If not, what approach do you consider we should take and why?

Valuation of DB pension scheme benefits

3.7 We have considered two approaches to calculating the value of the DB pension scheme that the consumer was advised to transfer out of.

i. The first is to follow the same approach as the Pensions Review:

- Calculate the amount of pension that the consumer would have been entitled to receive in retirement by applying the actual increases applied up to the date of calculation, and making an assumption for the future level of increases between the calculation date and the consumer's retirement date.
- Convert the value of the pension income in retirement into a capitalised lump sum using assumed annuity factors that would apply at the retirement date.
- Calculate the current value of the lump sum by discounting from the retirement date to the date of calculation using an assumed growth rate.

ii. The second is to request a notional transfer value from the DB pension scheme as at the calculation date to reflect the current value of the benefits the consumer accrued in the scheme before the transfer. If the DB pension scheme no longer exists, we would provide a methodology to calculate this figure based on the approach taken by scheme actuaries.

3.8 The advantage of the first approach is that it is familiar to firms that have previously calculated redress in cases like this. It should also produce a broadly appropriate valuation of the benefits, on average, although the assumptions made for future values are not guaranteed. However, this approach is complicated and often leads to firms outsourcing the calculations to third party firms with the expertise to complete them. This can lead to delays and increases the costs for firms significantly, especially when the redress value is low, as the cost of having the calculation completed can match or exceed the value of the redress.

3.9 The advantage of the second approach is that it is more straightforward. It would reduce the cost of completing the calculation as some firms would be able to complete this themselves without having to use third party firms. However, the approach will vary from scheme to scheme, and we will need to give a specific calculation method for schemes that are no longer in operation. In addition, schemes are not legally obliged to provide this valuation and may be unwilling to absorb the costs where they do provide it. It is also unlikely that this valuation method would accurately reflect the actual cost of purchasing an annuity for the scheme member, as the calculations are completed on a different basis.

3.10 We consider that the best method is the Pensions Review approach, because it is more accurate and familiar to firms and calculation software providers.

Q2: Do you agree with our proposed approach for valuing the DB pension scheme benefits? If not, do you agree with the alternative approach or do you consider a different method would work better?

Redress methodology

3.11 Having decided to consult on continuing with the same overall approach as the Pensions Review calculation methodology, we then considered how to update the methodology and assumptions so that consumers are more likely to be able to reproduce the benefits that they held in their DB pension scheme. We appointed PwC to recommend changes to the methodology and assumptions. PwC has prepared a report of these, and it is published separately on our website.

3.12 Our thinking has been informed by the significant changes in both pensions and the wider economy. We have set out the areas that we have considered and the changes that we propose below.

3.13 For each area, we have given an indication of the likely impact of this change on the valuation of the scheme benefits in isolation for two example consumers. Further details of these examples are given in PwC's report. The calculations are based on a series of assumptions regarding the scheme benefits and the consumers' individual circumstances. As a result, the numbers are indicative only.

- Consumer A is 2 years from retirement with a DB pension scheme benefits that would have been £2,100 per annum (p.a.) at retirement.
- Consumer B is 20 years from retirement with a DB pension scheme benefits that would have been £3,100 p.a. at retirement.

3.14 We recognise that changing market conditions will have an impact on the underlying assumptions. PwC has provided worked examples which demonstrate the effect this has.

3.15 Where we have not commented on a specific aspect of the existing methodology, for example the calculation of death benefits, then the approach taken under the Pensions Review methodology should continue to apply.

Inflation

3.16 Under the current approach, the assumed rate of inflation is used to calculate redress. This is because many DB pension schemes link both their revaluation pre-retirement and increases post retirement to the rate of inflation.

3.17 The assumptions used for Retail Price Index (RPI) and Consumer Price Index (CPI) in the Pensions Review were:

- RPI – the Bank of England (BoE) implied inflation spot yield at a 25 year duration
- CPI – 1% p.a. below the assumed rate of RPI

3.18 We believe the BoE's implied inflation curve remains a reasonable basis for deciding the future level of RPI to use. However, we propose a different approach to deciding the precise rate because the Pensions Review did not take account of the time between the calculation date and retirement date when taking the future inflation rate assumption from the BoE curve.

3.19 In line with PwC's recommendation, we propose that the rate to use is derived from BoE's inflation curve to 25 years, extrapolated to longer terms to maintain consistency with the post retirement gilt yields. Pre-retirement, we propose that spot rates used are based on the term to retirement. Post retirement, we propose that forward rates are derived from the spot curve based on the period from normal retirement age to the weighted average payment term. This approach allows for consistency with the discount rate assumptions, and should better reflect expectations of short term inflation compared to the current method.

Table 1 – the impact of our inflation rate assumption proposal on the DB pension scheme benefits of two example consumers

Example	Scheme benefits value at calculation date – Pensions Review	Scheme benefits value at calculation date – new approach	% change
A	£52,200	£50,900	-2.5%
B	£40,800	£37,300	-8.6%

Q3: Do you agree with our proposal for the inflation rate assumption to be used in the methodology? If not, what rate should be applied and why?

Pre-retirement discount rate

3.20 This is the rate used to discount the value of the DB pension scheme benefits at retirement back to the calculation date. It is the rate at which the investments in the consumer's personal pension are expected to grow between the calculation date and their retirement date. So after receiving redress and investing it in their personal pension, the value of the personal pension should be expected to reach a size at retirement that enables the consumer to buy an annuity that is the same as the income they would have received from their DB pension scheme.

3.21 The current approach to the pre-retirement discount rate assumes that the consumer holds a portfolio of 50% equities and 50% gilts until they reach 10 years from their retirement date. At this point, it is assumed that the portfolio moves on a linear basis towards 100% gilts on the consumer's retirement date. This reflects the typical approach consumers took to reduce the risk of their pension portfolio before buying an annuity, before 'pension freedoms' were introduced.

3.22 We have looked at consumers' attitude to risk from when they initially invest for retirement, and how that attitude and capacity might change as they approach retirement, to come to a proposal for a suitable pre-retirement discount rate.

Attitude to risk

3.23 We have considered the investment strategy that consumers typically employ in practice when they invest for retirement. We have also considered what constitutes an appropriate investment strategy for consumers who have been given unsuitable advice to transfer out of their DB pension scheme.

3.24 In a DB pension scheme, the scheme bears the investment risk. If the scheme remains solvent, the consumer is guaranteed to receive their benefits at retirement regardless of the investment conditions. The PPF provides a guarantee that broadly 90% of the member's benefits will be paid at retirement, within certain limits[16], if the pension scheme becomes insolvent.

3.25 We considered whether the consumer should accept a similar level of investment risk for their personal pension as they would have had in their DB pension scheme. Reflecting the existence of the PPF and assuming that the consumer's expected future pension is below the PPF limit implies using a mix of 90% gilts and 10% equities as the investment approach up to retirement. This also implies using a cap on the amount invested in gilts to reflect the PPF cap. However, this is very different to the typical long-term equity-based investment approach usually used for pensions. Additionally, consumers will generally be likely to achieve better investment returns than a rate that assumes a 90% gilts portfolio. Using a PPF consistent approach would result in a pension pot at retirement that is likely to be more than is required to buy an annuity that matches the value of the scheme benefits lost. This approach could, therefore, be unfair on the firms providing the redress, although not following it will mean exposing consumers to some investment risk.

[16] Further details can be found on the PPF's website: http://www.pensionprotectionfund.org.uk/Pages/Compensation.aspx

3.26 As the advice to transfer out of the DB pension scheme was found to be unsuitable, the affected consumers may have had a relatively cautious attitude to risk. This, coupled with the lower risk faced by DB pension scheme members, has led us to decide we should use the equivalent of a cautious (but not zero risk) investment strategy to calculate the pre-retirement discount rate.

Attitude to risk towards retirement

3.27 The second element of the approach is the assumed reduction in the level of risk in the portfolio as the consumer approaches retirement – known as 'life-styling'. Pension freedoms have given consumers a wider choice when deciding how to take their pension benefits at retirement. In particular, there is no longer a requirement to buy an annuity, and fewer consumers are buying an annuity with their pension. As a result, we believe there is now less need to eliminate risk as retirement approaches, as consumers' choices show they are willing to continue accepting investment risk into their retirement.

3.28 We have concluded that there should be an element of 'life-styling' in the investment approach but not to the same extent as for the Pensions Review. As stated above, our proposal for the pre-retirement discount rate is to assume a cautious investment mix.

3.29 We recognise that different consumers will have different attitudes to and capacity to take risk. We also acknowledge that our proposed approach requires the consumer to accept more investment risk than they faced in their DB pension scheme.

Our proposed approach

3.30 In line with PwC's recommendation, the pre-retirement discount rate that we propose is based on the following:

- One half of the expected return on equities (defined in terms of the FTSE all share index[17] and then used in conjunction with the formula below) until the consumer is five years from the normal retirement age of the DB pension scheme. This is roughly equivalent to a 67% gilt/33% equity holding.
- A linear decrease in the expected return over the final five years so the portfolio is aiming to achieve one third of the expected return on equities at the point of retirement.

3.31 We propose that this approach is calculated using the same method as the Pensions Review in principle, i.e. the expected return allows for expected inflation, the current dividend yield and an allowance for future growth in dividends. The expected return on equity in year t is defined as:

$$(1 + \text{RPI assumption}_t) * (1 + \text{dividend yield}) * (1 + \text{growth in dividends}) - 1$$

The inflation assumption in each year, t, is based on the forward rate in each year. The effect of this is that the pre-retirement discount rate for each customer will differ

[17] http://www.ftse.com/products/indices/uk

according to the term to retirement. This differs marginally from PwC's proposed approach, which is to use constant spot rates. However, we believe that use of forward rates is a slightly more robust and technically correct approach over different market conditions.

Table 2 – the impact of our pre-retirement discount rate proposal on the DB pension scheme benefits of two example consumers

Example	Scheme benefits value at calculation date – Pensions Review	Scheme benefits value at calculation date – new approach	% change
A	£51,500	£51,800	+0.6%
B	£35,300	£42,400	+20.1%

3.32 Our proposal is to apply this approach to all consumers, regardless of their circumstances and attitude to investment risk. We considered specifying different discount rates, based on the consumer's attitude to risk, as this would impact the potential future growth of the pension policy. However, we decided that this would make the methodology more complex and could make it difficult for firms to identify the correct attitude to risk to apply, as this would directly affect the level of redress.

Q4: Do you agree with our proposal for the pre-retirement discount rate to be used in the methodology? If not, what approach do you consider should be used and why?

Q5: Do you agree that there should be one approach to the pre-retirement discount rate applied to all consumers? If not, how should the other rates be determined?

Pension Protection Fund (PPF)

3.33 We have set out above our thinking on acknowledging the PPF in the pre-retirement discount rate used where the scheme is still solvent. We have also considered the approach to take where the scheme has become insolvent and entered the PPF.

3.34 We consider that the calculation should reflect the level of benefit that the consumer would receive from the PPF, rather than the notional scheme benefits that would have been paid if the DB pension scheme had remained solvent. This will reflect the actual increases that the PPF will use both pre and post retirement.

3.35 We have also looked at whether the pre-retirement discount rate should be different for these consumers, as the benefits are guaranteed to be paid. PwC suggests using a pre-retirement discount rate that is based purely on gilt returns. This would substantially increase the value of the scheme benefits for members that have a significant time period until retirement. This could mean the scheme benefits become more valuable if the scheme became insolvent and entered the PPF.

3.36 We consider that the likelihood of this scenario is rare and have not been made aware that this scenario has happened in practice. Our view is that an individual's attitude to risk remains the same regardless of whether their DB scheme has become insolvent and entered the PPF, although we think that there is possibly some validity to treating PPF benefits differently.

3.37 We propose for the purposes of the methodology that the same pre-retirement discount rate should be used regardless of whether a DB scheme has entered the PPF. However, in the event of a scheme going into the PPF after transfer, we would expect firms to take account of individual circumstances and consider whether it is appropriate to reflect the PPF cap and level of benefits.

Q6: Do you agree that the same pre-retirement discount rate proposed for DB pension scheme benefits should be used for PPF benefits? If not, what rate should be applied and why?

Personal Pension (PP) charges

3.38 The current methodology reduces the value of the consumer's personal pension to make an allowance for future charges. The reduction applied is dependent on the charges applied to the consumer's personal pension at the date of review.

3.39 In line with PwC's recommendation, we propose that a fixed rate allowance of 0.75% p.a. should be used for personal pension charges to simplify the calculation. The allowance is deducted from the pre-retirement discount rate. The effect of this assumption will depend on the level of charges that the consumer is currently paying in their personal pension. We consider that this is a fair approach as the actual charges may have varied over the period of the arrangement.

3.40 To illustrate this we have set out below two tables showing the effect on the value of the DB scheme benefits for our example consumers paying 0.5% p.a. and 1% p.a. in charges. We have shown the impact on the value of the scheme benefits for consistency with the other examples, but this may also be allowed for by adjusting the value of the personal pension used in the calculation. These tables reflect the proposals set out in Table 2 as well as the assumption for charges.

Table 3 – the impact of our personal pension charges assumption proposal on the DB pension scheme benefits of two example consumers paying 0.5% p.a.

Example	Scheme benefits value at calculation date – Pensions Review (0.5% charges)	Scheme benefits value at calculation date – assumption of 0.75% PP charges	% change
A	£52,000	£52,500	+1.0%
B	£38,900	£49,000	+26.0%

Table 4 – the impact of our personal pension charges assumption proposal on the DB pension scheme benefits of two example consumers paying 1.0% p.a.

Example	Scheme benefits value at calculation date – Pensions Review (1.0% charges)	Scheme benefits value at calculation date – assumption of 0.75% PP charges	% change
A	£52,500	£52,500	0.0%
B	£42,800	£49,000	+14.5%

Q7: Do you agree with our proposal for valuing personal pension charges in the methodology? If not, what approach should be taken and why?

Post retirement discount rate

3.41 This is the rate used to calculate the capitalised value of the DB pension scheme benefits through retirement that the consumer would have received if they had not transferred. In effect, the capitalised value is the amount required to buy an annuity that matches the pension that would have been paid by the DB pension scheme.

3.42 We have considered the current approaches taken by the Statutory Money Purchase Illustration (SMPI) projections and FCA projections for the Transfer Value Analysis (TVA) calculations. The SMPI is issued to members of money purchase pension schemes to show the amount of future pension in 'real terms' that they might be paid under the

scheme. The TVA is required when a consumer is advised to transfer DB pension scheme benefits to a personal pension. It calculates the investment return which is required from a personal pension fund to provide the same benefits as those given up by transferring.

3.43 Both SMPI/FCA projections and TVA aim to model a current risk-free post retirement income stream and so have very similar approaches. Following a discussion question in CP15/30[18] with the findings published in PS16/12[19], we are aware that the majority of respondents felt that, given the pension freedoms, the use of the TVA needed to be reconsidered.

3.44 PwC recommends using the nominal gilt liability curve published by the BoE to derive future post retirement discount rates, based on average weighted payment terms linked to the original scheme's normal retirement age.

3.45 We agree that the gilt curve approach is more appropriate for this methodology because it can be used to derive expected future gilt yields at each member's expected retirement date, rather than the rate that applies at the time of the redress calculation.

3.46 We did consider whether the use of a risk-free rate was appropriate given that some annuity providers may use higher yielding investments to match their annuity portfolios. However, we are aware that this may also result in higher margins being retained by providers to offset higher solvency requirements. On balance, we consider that the risk-free approach is more intuitive and, from a pragmatic perspective, can be more readily calculated from publicly available information.

3.47 We propose to use PwC's recommended approach. While we recognise that the TVA method is familiar to firms, we consider that the act of advising on a transfer and communicating the acceptance of future investment and mortality risk is a sufficiently different process from that of compensating consumers who have suffered actual loss as a consequence of being misadvised.

Annuity pricing

3.48 The current methodology includes a loading of 4% of the annuity for the implicit costs incurred in converting the fund into an income stream at retirement. As the proposed methodology seeks to replicate the cost of converting the fund using an annuity, we consider it appropriate to incorporate an allowance for the costs and profit of annuity providers.

3.49 We propose to use PwC's recommendation, which is to make a deduction of 0.6% from the post retirement discount rate to allow for annuity provider pricing and reserving. We believe that this provides a reasonable proxy to annuity pricing and will replicate fairly closely the rates currently available on the market.

[18] CP15/30 'Pension reforms – proposed changes to our rules and guidance' (October 2015): https://www.fca.org.uk/publications/consultation-papers/cp15-30-pension-reforms-%E2%80%93-proposed-changes-our-rules-and-guidance

[19] PS16/12 'Pension reforms – feedback on CP15/30 and final rules and guidance' (April 2016): https://www.fca.org.uk/publications/policy-statements/ps16-12-pension-reforms-%E2%80%93-feedback-cp15-30-and-final-rules-and

Table 5 – the impact of our post retirement discount rate proposal and annuity pricing proposals on the DB pension scheme benefits of two example consumers

Example	Scheme benefits value at calculation date – Pensions Review	Scheme benefits value at calculation date – new approach	% change
A	£52,200	£60,000	+14.9%
B	£40,800	£51,600	+26.5%

Q8: Do you agree with our proposal for the post-retirement discount rate to be used in the methodology? If not, what approach should be applied and why?

Q9: Do you agree with the 0.6% deduction to reflect pricing models used by annuity providers?

Pension commencement lump sum

3.50 The Pensions Review did not make allowance for consumers to exchange part of their pension for a tax-free cash sum. PwC notes that, from experience, the majority of DB pension scheme members take a tax-free cash sum that is close to the maximum entitlement. As a result, we consider that it is reasonable to make allowance for consumers taking a cash sum in the redress methodology.

3.51 The amount of pension required in exchange for a cash sum varies between DB pension schemes. As it is very complex to determine individual scheme approaches, in line with PwC's recommendation, we propose that firms should apply a blended post retirement discount rate to reflect that the cash sum has a lower actuarial value than the pension income that was given up to secure it (although it is tax-free in the hands of the individual). This rate combines 75% of the 'pension' rate and 25% of the 'lump sum' rate to form the overall rate to use

3.52 In line with PwC's recommendation, we propose an adjustment of 1.6% to the post retirement discount rate per year when calculating that 25% of the benefits are likely to be taken as the tax-free cash lump sum.

3.53 This has the effect of reducing the value of the scheme benefits as shown in the following table. We consider that the rate proposed makes a fair allowance for typical commutation factors used by schemes, and could be subsequently reviewed against market conditions if required.

Table 6 – the impact of our pension commencement lump sum proposal on the DB pension scheme benefits of two example consumers

Example	Scheme benefits value at calculation date – Pensions Review	Scheme benefits value at calculation date – new approach	% change
A	£52,200	£49,400	-5.4%
B	£40,800	£38,500	-5.6%

Q10: Do you agree that the redress methodology should take account of the pension commencement lump sum?

Q11: If so, do you agree with the approach and the rate proposed to account for this? If not, what approach should be applied and why?

Mortality

3.54 The mortality assumptions used in the calculation estimate how long the consumer is expected to live and how long their DB pension scheme would have been paid.

3.55 PwC recommend using the mortality rates used in the Conduct of Business Sourcebook (COBS) when providing projections or a TVA.

3.56 We have also considered whether we should make allowance for the likelihood of the consumer being in ill-health when they retire and so qualify for an impaired life annuity. As the rates offered could be significantly greater than for a pensioner in normal health, the amount of redress required to match the DB scheme income could be significantly less. This could be achieved by using a blended approach to mortality rates; we could use a combined table which incorporates the experience of pensioners in both normal and ill-health.

3.57 However, it is difficult to assess the likely future health of individual consumers and the impact this could have on the level of redress they are offered. So we believe that using the same table as COBS provides a more pragmatic solution than using a combined table.

3.58 We propose to use the COBS tables because they more accurately reflect the cost to consumers of buying an annuity and they are publicly available. Specifically this is the PxA08 series adjusted for future mortality improvements, as set out in Annex 1.

Gender-neutral annuity rates

3.59 The Pensions Review used gender specific annuity rates to value the DB pension scheme benefits. This does not reflect the current market approach to pricing annuities.

3.60 PwC recommend using gender-neutral annuity rates. This proposal reflects the market approach to pricing annuities and makes it more straightforward for consumers to secure redress as a result. However, it does affect men and women differently compared to the previous approach under the Pensions Review. Generally, this will increase the level of redress for men and decrease the level of redress for women.

3.61 However, we consider this move addresses the issue with the previous approach that men would not have been able to get the annuity rate that is used in calculations in the open market (as the market rates are quoted on a gender-neutral basis). Additionally, women received more redress than was required to purchase the relevant annuity because of the gender-neutral annuity rate in the market.

3.62 In line with PwC's recommendation, we propose to use gender-neutral annuity rates to reflect the market approach. The annuity rate will therefore be calculated by taking the average of the male and female mortality rates.

Q12: Do you agree with our proposal to use PxA08 mortality tables adjusted for future mortality improvements? If not, what tables should be used and why?

Q13: Do you agree with our gender-neutral approach to mortality in the methodology? If not, what approach should be used and why?

Spouse's age difference

3.63 The Pensions Review made the assumption that men were three years older than their wives. This assumption is used to calculate the value of the spouse's pension after the pensioner's death. Apart from the question of whether this approach remains appropriate, it does not take account of same-sex marriage. The aim of the redress methodology and related assumptions is to enable firms to calculate and pay redress to consumers.

3.64 We believe removing the previous assumption about spouses' age differences is proportionate to achieving this aim. Different DB pension schemes may provide differently for consumers with same sex spouses and consumers or their spouses who have undergone gender reassignment. Our proposal does not require firms to request specific information about these issues from the relevant DB pension scheme. Having a standardised approach by treating all consumers equally irrespective of gender or sexual orientation simplifies the calculation, and so allows firms to pay redress more quickly. Standardising the approach to this particular assumption also means that customers do not have to give additional sensitive data to firms.

3.65 In line with PwC's recommendation, we propose to assume that male and female consumers are the same age as their spouse. This will ensure the same approach is used in calculations regardless of whether spouses are of the same sex or not and of whether the consumer or spouse has had gender reassignment. However, this could result in

indirect discrimination against certain groups with protected characteristics because, for example, we are applying male characteristics to women and vice versa.

3.66 The following table shows the impact of using gender-neutral annuity rates and assuming that male and female consumers are the same age as their spouse on the two example scheme members.

Table 7 – the impact of our gender-neutral approach and spouses' age difference assumption on the DB pension scheme benefits of two example consumers

Example	Scheme benefits value at calculation date – Pensions Review	Scheme benefits value at calculation date – new approach	% change
A – male	£52,300	£52,700	+0.8%
A – female	£52,400	£52,700	+0.6%
B – male	£40,900	£41,700	+2.0%
B – female	£41,000	£41,700	+1.7%

Q14: Do you agree with our proposal to assume that consumers are the same age as their spouse? If not, what approach do you think should be used and why?

Proportion married or in a civil partnership at retirement

3.67 The Pensions Review considered the proportion of people who were married at retirement to decide whether the benefits paid to the spouse after the pensioner's death needed to be valued. This was based on the length of time before the consumer's retirement date.

3.68 We propose a simpler approach, and are updating the assessment to include civil partnerships. Data published by the Office for National Statistics (ONS) shows a general decline in the proportion of the population who are married, however many DB pension schemes are broadening their definition of who is a 'dependant' so that more people are eligible for payments.

3.69 For these reasons, and in line with PwC's recommendation, we propose a single assumption of 85% for the percentage of people married or in a civil partnership at retirement. This takes into account the ONS's statistics from the latest UK census that shows around 70-75% of the population aged 60-69 were either married or in a civil partnership[20], and is adjusted for the widening in the definition of dependant used by schemes.

3.70 We recognise that using a standard assumption for all consumers will mean some consumers get redress which is higher or lower than is justified by their individual circumstances. However, we consider that collecting individual data when making the

[20] https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/bulletins/populationestimatesbymaritalstatusandlivingarrangements/2002to2015

calculation, which may or may not be still relevant by normal retirement age, would unnecessarily complicate the calculation.

Table 8 – the impact of the proportion married at retirement on the DB pension scheme benefits of two example consumers

Example	Gender	Marital status	Scheme benefits value at calculation date – Pensions Review	Scheme benefits value at calculation date – new approach	% change
A	Male	Married	£53,000	£52,300	-1.3%
A	Male	Unmarried	£47,700	£52,300	+9.6%
A	Female	Married	£52,900	£52,300	-1.1%
A	Female	Unmarried	£47,600	£52,300	+9.9%
B	Male	Married	£40,900	£40,900	0.0%
B	Male	Unmarried	£38,800	£40,900	+5.4%
B	Female	Married	£40,500	£40,900	+1.0%
B	Female	Unmarried	£38,800	£40,900	+5.4%

Q15: Do you agree with the proposed methodology for assessing the likelihood of consumers being married or in a civil partnership at retirement? If not, what approach should be applied, and why?

Enhanced transfer values (ETVs)

3.71 We have considered how to make allowance for cases where consumers received an enhancement to their scheme benefits when they transferred out of the DB pension scheme. These enhancements need to be allowed for in the calculation to enable a fair comparison.

3.72 In line with PwC's recommendation, we propose that where the enhancement was paid as part of the transfer value then this will be allowed for as part of the normal calculation approach and no further adjustments are required.

3.73 Where the enhancement was paid as a cash lump sum outside the transfer process, we propose to apply a consistent approach to the valuation of this sum, whether or not the consumer has invested or spent it. We propose that the actual increases to the consumer's personal pension are applied from the date of payment to the redress calculation date. This figure is then added to the value of the consumer's personal pension policy for the purpose of the redress calculation. This differs slightly to PwC's proposed approach in order to be pragmatic.

Q16: Do you agree with the proposed methodology for valuing enhancements to the transfer values? If not, what approach should be applied and why?

Frequency of updates

3.74 Under the Pensions Review, assumptions were initially updated on a three-monthly basis. As the number of cases reduced over the course of the review, the frequency of the updates reduced to once a year. PwC has provided the Financial Ombudsman Service updates for the existing methodology on an annual basis.

3.75 We propose that the economic assumptions which are based on public information are updated every quarter in order to reflect changing market conditions. Specifically, firms should review and update the inflation and gilt yield curves together with the dividend yield based on their values on the last working day of every quarter, for calculations commencing on the first working day of each quarter. The mortality assumption mirrors the assumption in COBS projections and TVA which changes automatically every year on 6 April. For ease, we propose that for redress calculations, it should be updated at the end of March along with the update of the publicly available economic assumptions.

3.76 We also propose to review the overall methodology at least every four years, or sooner if feedback from stakeholders suggests that there may be a need, to ensure that it continues to provide appropriate redress.

Q17: Do you agree that firms should update the relevant assumptions on a quarterly basis? If not, please tell us why.

Q18: Do you agree with our approach to reviewing the methodology? If not, please tell us why.

Applicability of the methodology

3.77 The current methodology is also used to calculate redress in complaints for non-joiner, opt-out and FSAVC[21] redress cases.

3.78 Whilst PwC has not specifically considered whether the proposed methodology should apply to these complaints as it was outside its scope, some stakeholders have argued that doing so would simplify complaint handling and ensure that consumers receive more appropriate redress. We are interested in your views on whether our proposed methodology should be used in these cases. Similarly, we are seeking views on whether there is a case for applying the methodology more broadly to redress on advice to transfer safeguarded benefits following the change to the pension transfer definition in June 2015.

Q19: Do you think that our proposed redress methodology should be applied to complaints relating to non-joiners, opt-outs and FSAVC cases? If yes, why? If not, how should redress for these cases be calculated and why? For example, should any adjustments be made so that the proposed methodology can be used for these cases?

[21] FSAVC – an arrangement which allows a member of an occupational pension scheme to make additional voluntary contributions to a personal pension, where the personal pension is separate from, but associated with, an occupational pension scheme.

> **Q20: Do you think that our proposed redress methodology should be applied to complaints relating to transfer of other safeguarded benefits? If yes, why? If not, how should redress for these cases be calculated and why? Is there a need to differentiate between different types of safeguarded benefits?**

Tax and wider considerations

3.79 We have not provided specific guidance on how tax should be factored into redress payments. This is a matter for Her Majesty's Revenue and Customs to consider. We propose that the redress payment should be paid directly into the consumer's personal pension where possible and to pay a lump sum otherwise. In either scenario, firms must take account of the consumer's tax position and ensure that any tax restrictions or liabilities have been allowed for appropriately. Consumers may choose to pay any lump sum into an Individual Savings Account, where this is appropriate and possible.

3.80 Firms should also take the consumer's wider circumstances into account so that they are not disadvantaged through receiving the redress payment.

> **Q21: Do you agree with the approach that we have set out for redress payments?**

Overall impact of our proposals on the value of DB pension scheme benefits

3.81 The table shows examples, provided by PwC, of how our proposals would impact the value of the DB pension scheme benefits. Further details about these examples of hypothetical consumers are provided in PwC's report.

Table 9 – the overall impact of our proposals on the DB pension scheme benefits of example consumers

Example	Details	Scheme benefits value at calculation date – Pensions Review	Scheme benefits value at calculation date – new approach	% change
1	Retire immediately; scheme pension of £2,000 p.a.	£51,600	£56,800	+10.1%
2 (Example A)	Retire in 2 years; scheme pension of £2,100 p.a.	£52,200	£56,000	+7.3%
3	Retire in 7 years; scheme pension of £2,300 p.a.	£51,300	£54,000	+5.3%
4	Retire in 15 years; scheme pension of	£44,600	£53,600	+20.2%

Example	Details	Scheme benefits value at calculation date – Pensions Review	Scheme benefits value at calculation date – new approach	% change
	£2,800 p.a.			
5 (Example B)	Retire in 20 years; scheme pension of £3,100 p.a.	£40,800	£53,800	+31.9%

Q22: Are there any other aspects of the existing methodology that we have not covered in this paper that need to be updated? If so, what changes do you consider need to be made and why?

Annex 1 Proposed guidance

Terminology used in this guidance

Assumed retirement date	The earliest date that a customer could retire and receive a non-reduced pension from their DB pension scheme, calculated based on the assumption of the customer's retirement age (see paragraphs 11 and 12).
DB pension scheme	A defined benefit pension scheme.
Deferred revaluation rate	The assumed future rate of increase in deferred pension before the assumed retirement date, set out in the rules of the relevant DB pension scheme.
Pension increase rate	The assumed rate of increase in pension after the assumed retirement date, set out in the rules of the relevant DB pension scheme.
Respondent	A term that is used in the FCA's Handbook to define those persons who may receive complaints from customers which fall within the compulsory jurisdiction or the voluntary jurisdiction of the Financial Ombudsman Service. It includes authorised persons, participants in the voluntary jurisdiction of the Financial Ombudsman Service, and in certain circumstances unauthorised persons who were authorised at the time of the act or omission to which the complaint relates.

Introduction

1. This guidance is relevant to respondents who receive a complaint about advice they gave to transfer all or part of the cash value of accrued benefits under a DB pension scheme into a personal pension scheme. In particular, the guidance contains assumptions which respondents should use to calculate appropriate redress in circumstances where:

    - the customer received advice from the firm which was negligent or contravened relevant requirements; and

    - if the advice had not been negligent or had complied with the relevant requirements, the customer would not have transferred all or part of the cash value of accrued benefits from the DB pension scheme into the personal pension scheme.

The standard approach to calculating redress

2. Where a firm or adviser has failed to give compliant and proper advice, or has committed some other breach of the relevant requirements, the basic objective of redress is to put the customer, so far as possible, into the position they would have been in if the non-compliant or unsuitable advice had not been given or the breach had not occurred. While each case should be assessed individually, in many cases this advice is likely to have resulted in the complainant transferring accrued benefits from a DB pension scheme to a personal pension scheme. This is what underpins the standard approach to redress.

3. Where possible, the redress calculation should reflect the features of the customer's original DB pension scheme. This will include, for example, different tranches of pension increase rates, deferred revaluation rates and so on.

4. A respondent should consider how far they should take into account any adjustments to the benefits which the customer would have been eligible for under the DB pension scheme when they complete the redress calculation. This could include, for example, adjustments to benefits after retirement to reflect a state pension offset or the scheme entering the Pension Protection Fund (PPF).

5. If it is not possible to pay the redress amount into the customer's personal pension by augmentation, the redress should be paid in the form of a lump sum to the customer, adjusted to take account of the customer's individual tax position. A customer should not be left in a worse position as a result of the redress either being used to augment their personal pension or being paid as a lump sum. In calculating the redress amount, respondents should also take into account the customer's wider circumstances so that they are not disadvantaged by receiving the redress payment.

Assumptions for use in redress calculation from 3 August 2016

6. Except where expressly specified below, redress should be calculated in accordance with, and using the assumptions set out in, the provisions designated by the Financial Services Authority (FSA) in November 2001[22] (subject to any amendments made by the FSA after that date) for the selling of rights in, or interests under, personal pension schemes, between 29 April 1988 and 30 June 1994, where those provisions relate to pension transfers.

7. This guidance applies to any complaint received by a firm after 3 August 2016 about advice given to a customer to transfer all or part of the cash value of accrued benefits under a DB pension scheme into a personal pension scheme, and for any such complaint which was received before 3 August 2016 but not settled on a full and final basis on or before that date. The guidance does not apply to cases falling within the scope of the Pensions Review or the Free-Standing Additional Voluntary Contributions (FSAVC) Review.

Retail Price Index (RPI) inflation

8. The RPI inflation assumption is based on the implied RPI inflation rate spot curve published by the Bank of England to 25 years. The curve should be extrapolated to longer terms using the average difference between inflation and gilt yields over the terms 21 to 25 years, and for terms shorter than 3 years by assuming the 3 year rate applies. The RPI inflation rate should be derived as follows:

    - pre-retirement: by taking the spot rate for the term to retirement, and

[22] These provisions were designated by the FSA in the Designation of Pensions Review Provisions Instrument 2001 (FSA 2001/71), dated 15 November 2001.

- post retirement, by taking the derived forward rates from normal retirement age to the age indicated by adding on the discounted mean term, using the same methodology as that for the post retirement discount rate (paragraph 26)

9. The final assumptions should be rounded to the nearest 0.05%.

Consumer Price Index (CPI) inflation

10. CPI inflation is 1% below the assumption for RPI inflation.

Consumer's retirement age

11. The earliest age at which the customer could have retired from the DB pension scheme without:

    - requiring the consent of the employer, and
    - suffering a reduction in benefits

12. Where a customer has benefits payable from different ages, the redress calculation should reflect the most favourable option for the customer.

Pre-retirement discount rate

13. The pre-retirement discount rate is derived from the returns targeted in each year up to retirement.

14. While the customer is more than five years from retirement, the target return is one half of the expected return on equities.

15. Where the customer is less than five years from retirement, the target return decreases linearly from the rate identified in paragraph 19 to an expected return of one third of the expected return on equities at the precise assumed retirement date.

16. The expected return on equity in each year is:

    $(1 + \text{RPI inflation assumption}_t) * (1 + \text{dividend yield}) * (1 + \text{growth in dividends}) - 1$

17. Prospective long-term real dividend growth is assumed to be 0.5% per year. The dividend yield should be taken to be the dividend yield on the FTSE All Share Index on the last business day of the quarter.

18. The RPI inflation assumption in any year, t, is the one year forward rate derived from the inflation spot curve as:

    - 1 plus the spot rate on the inflation curve for year x+1; divided by
    - 1 plus the spot rate on the inflation curve for year x; then
    - Less 1

19. For the last five years prior to retirement, the equity return should be determined in the middle of the year, by averaging the returns at each year end.

20. The gross pre-retirement discount rate is calculated as the product of (1 plus the equity return) for each year t to retirement, raised to the power of (1 divided by the term to retirement) less 1, rounded to the nearest 0.05%.

Pension increases in payment

21. This is the relevant pension increase rate together with either the RPI inflation assumption or the CPI inflation assumption (depending upon the rules of the relevant DB pension scheme).

22. If the rules of the relevant DB pension scheme impose a cap:

    - the cap specified by these rules should be used where the relevant inflation assumption is higher than the cap, or
    - the relevant inflation assumption should be used where it is below the cap

23. If the rules of the relevant DB pension scheme impose a floor:

    - the floor specified by these rules should be used where the relevant inflation assumption is lower than the floor, or
    - the relevant inflation assumption should be used where it is above the floor

24. Where fixed pension increases are granted under the customer’s DB pension scheme, those fixed pension increase rates should be used.

Personal pension charges

25. Deduct 0.75% per year from the pre-retirement discount rate for personal pension charges.

Post retirement discount rate

26. The initial post-retirement discount rate is calculated by:

    - taking the spot rate on the nominal gilt liability curve using a term equal to the sum of the period to retirement and the discounted mean term from the table below, adding 1, and raising to the power of the sum of the period to retirement and the discounted mean term; divided by
    - taking the spot rate on the nominal gilt liability curve using a term equal to the sum of the period to retirement, adding 1, and raising to the power of the period to retirement; then
    - raising the result to the power of (1 divided by the discounted mean term), subtracting 1 and round to the nearest 0.05%; then
    - deducting 0.6% from the rate to allow for the margins built into annuity pricing

27. The final rate adjusts for the pension commencement lump sum by taking:

    - 75% of the initial rate, plus

- 25% of the initial rate plus 1.6%

28. This rate is used to calculate a joint life annuity plus a single life annuity. Take 85% of the joint plus 15% of the single.

29. The discounted mean term is dependent on the assumed retirement age as follows:

Assumed retirement age	Discounted mean term
55	23
60	20
65	16

30. Discounted mean terms for other assumed retirement ages up to 65 should be based on linear interpolation and rounded to the nearest integer age. For assumed retirement ages above 65, the discounted mean term should be reduced by 1 for each additional year before retirement.

Mortality

31. Mortality should be calculated using 100% of the PxAo8 tables, published by the Institute and Faculty of Actuaries' Continuous Mortality Investigation, assuming male and female mortality in equal parts.

32. Improvements in mortality should use the male and female annual CMI Mortality Projections Models in the series CMI (20YY-2)_M_[1.25%] and CMI (20YY-2_F)_[1.25%] in equal parts for the year commencing 1 April 20YY.

Spouse's age difference

33. A customer's spouse is considered to be the same age as the customer.

Proportion married at retirement

34. 85% married at retirement.

Enhanced transfer value

35. Where a cash enhancement was paid in addition to the transfer value, the actual net of charges increases experienced by the consumer's personal pension attributable to the original transfer value (excluding any new contributions or withdrawals) should be applied to the cash enhancement and the figure added to the value of the consumer's personal pension policy.

Annex 2 Cost benefit analysis

Introduction

1. Section 138I of the Financial Services and Markets Act (FSMA) requires us to publish a cost benefit analysis (CBA) when we propose rules. We are planning to provide for the proposed redress methodology by way of guidance; we are not proposing rules or rules changes. The guidance is made under section 139A and is not subject to the FSMA CBA requirement. However, we are required to have regard to our regulatory principles (including the need to act proportionately and transparently), and we have carried out a qualitative CBA of our proposal.

2. We asked firms to put all settlements on hold while we develop and consult on this new methodology. We did not consider it proportionate to carry out a fully quantitative CBA, as this would delay the process. Delay could lead to poorer outcomes for both firms and consumers: consumers cannot recover the money as quickly and firms would potentially pay out greater sums. We considered the extra delay disproportionate since the ability to quantify the size of the additional transfer from firms to consumers is unlikely to affect our decision to update the methodology.

Rationale for the proposal

3. Our proposals are more likely to put consumers back into the position that they would have been in if they had not transferred out of their DB pension scheme than the current methodology, and so helps advance our objective of securing an appropriate degree of protection for consumers.

4. The redress amount represents a transfer of wealth from firms to consumers. The methodological changes suggested in this paper aim to reflect the changes to the pensions landscape.

Counterfactual

5. If we do not issue guidance on how firms should calculate redress that is more likely to put consumers back in the position they would have been in if they had not transferred out of their DB pension scheme, the industry may continue to use the current methodology. Another possibility is that the industry could depart from using the existing methodology and develop various alternative methodologies, resulting in inconsistencies between the way that firms, the Financial Ombudsman Service and the FSCS address these complaints.

6. We have assessed the proposal against a 'counterfactual' that shows the position if the previous methodology continued to be used.

The effects of the proposal, and its costs and benefits

Redress payments

7. We have considered whether we can estimate the scale of the impact of our proposal on redress payments, and we have found difficulties doing this. This is because the redress amount is very sensitive to the characteristics of the individual seeking redress. In particular, it depends on the individual's:

    - current age
    - retirement age
    - DB pension scheme they were otherwise entitled to
    - DB pension scheme structure: for example, whether the level of payments changed, and whether it included an adjustment for inflation
    - date of leaving the DB pension scheme
    - enhanced transfer value
    - pension commencement lump sum amount
    - savings in the personal pension

8. To estimate the average change from the new methodology, we would need to get these details from a representative sample of consumers. We would then need to estimate how much the consumers would have been entitled to under the current methodology and compare this to their entitlement under the proposed methodology. We did not consider it reasonably practicable to do this because of the difficulty in acquiring a representative sample of data and the length of time we would need to calculate appropriate redress under the current and proposed methodologies. When we announced our intention to consult on whether and, if so, how, to amend the redress methodology we said we did not believe it was fair for firms to seek to settle complaints about pension transfer advice while the consultation was ongoing. We do not want to delay the settlement of pension transfer complaints longer than necessary so that consumers can receive appropriate redress as soon as possible.

9. While we have not been able to gather a representative sample of data, we have considered information that we hold as a result of our ETV thematic review[23] and, separately, information that we have requested from the Financial Ombudsman Service. These data give us enough information to be able to estimate the average redress under the current methodology and the average length of time until the assumed retirement age of 65. However, we do not have information about the value of the DB pension scheme benefits and the value of savings in the personal pension. As a result, we cannot estimate how the new methodology would affect the overall level of redress. In particular, we cannot estimate how individual changes would affect the overall level of redress.

10. Two examples from PwC are provided in Chapter 3 and further details of these examples are available in PwC's report. The examples in this paper illustrate the effect of our proposals on hypothetical consumers but cannot be generalised. This is because the examples given are not representative of the average consumer.

[23] https://www.fca.org.uk/news/press-releases/fca-publishes-results-thematic-reviews-enhanced-transfer-values-and-sipp

Information from an ETV sample

11. Our ETV sample contains data on a small group of consumers that we gathered from one firm as a result of our ETV thematic review. This sample consists of 68 cases where consumers received unsuitable advice. We have reviewed this data and found that the consumers had an average of 12 years until the assumed retirement age of 65, and suffered an average loss of around £27,000. The average enhancement to the transfer value was around £11,000. The average redress in ETV cases may be lower than the average redress for general pension transfer complaints, because the value of the enhancement increased the value of the personal pension, and reduced the difference between the value of the DB pension scheme and the personal pension, so reducing the amount of redress. However, the effect of this would obviously depend on the value of the relevant enhancement.

12. As this sample relates to one firm rather than all relevant firms, this data may cover an unrepresentative sub-set of consumers, and consumers' circumstances may vary much more widely across other ETV cases.

Information from the Financial Ombudsman Service

13. We have reviewed a sample of data from the Financial Ombudsman Service that consists of 49 pension transfer complaints that it resolved in 2015/16. This may include a small proportion of complaints about opt-outs. We found that consumers had an average of six years until the assumed retirement age of 65. Unlike our ETV sample, this sample specifies what the Financial Ombudsman Service expects the redress will be. It includes wide redress ranges, such as '£1,000 to £24,999' and '£25,000 to £75,000', instead of specific redress amounts. The average redress, based on the mid-point of each range, is around £58,000. We note that the actual redress in these cases may have been closer to the lower or higher end of each range, so this average may not sufficiently reflect the estimated redress in these cases. Furthermore, the redress range of '1,000 to £24,999' had the highest volume of cases (19), so redress payments may be more likely to be within this range.

14. As well as concerns about the reliability of the expected redress data for this sample, it is possible that the sample may be unrepresentative of all pension transfer complaints. This is because firms may settle complaints with specific characteristics, such as those with higher or lower redress, with the consumer. As a result, a category of cases with particularly significant characteristics may not be shown in the Financial Ombudsman Service's data.

15. While we have not been able to get a representative sample of data, we can use the data above to a limited extent to indicate the potential average redress payment under the current methodology and the likely average duration until retirement. Based on our review of the data we have, we think that the average duration until retirement in pension transfer complaints is likely to be between 5 to 15 years, and that the average redress payment is likely to be around £20,000 to £60,000.

16. Examples provided by PwC show that our proposed methodology will increase the value of the DB pension scheme for a consumer with two years until retirement by 7.3% and the value of the DB pension scheme for a consumer with 15 years until retirement by 20.2%. Applying this to the details of an average consumer from our sample, who is likely to have 5 to 15 years until retirement, the average consumer's DB pension scheme value may increase by between 7.3% and 20.2% under our proposed methodology. However, the value of the consumer's DB pension scheme could also fall under the proposed methodology.

17. We have not been able to quantify how this would impact the average redress payment. Redress will clearly depend on the value of the average DB pension scheme benefits and the value of the average personal pension. The samples that are available do not include either piece of information. So, even though we know the percentage increase our proposed

methodology will make to the value of the average consumer's DB pension scheme benefits. We cannot calculate how this will affect the average redress payment as we do not know the absolute value of the average DB pension scheme.

18. Overall we expect that the average redress payment will increase as a result of the changes. This is primarily because our proposed methodology aims to reflect the risk of taking on a personal pension. We have not been able to quantify the impact of this on the average redress payment because it has not been reasonably practicable to collect sufficient data. Additionally, the impact of our proposed methodology on redress payments will vary across consumers and ultimately depend on their individual circumstances.

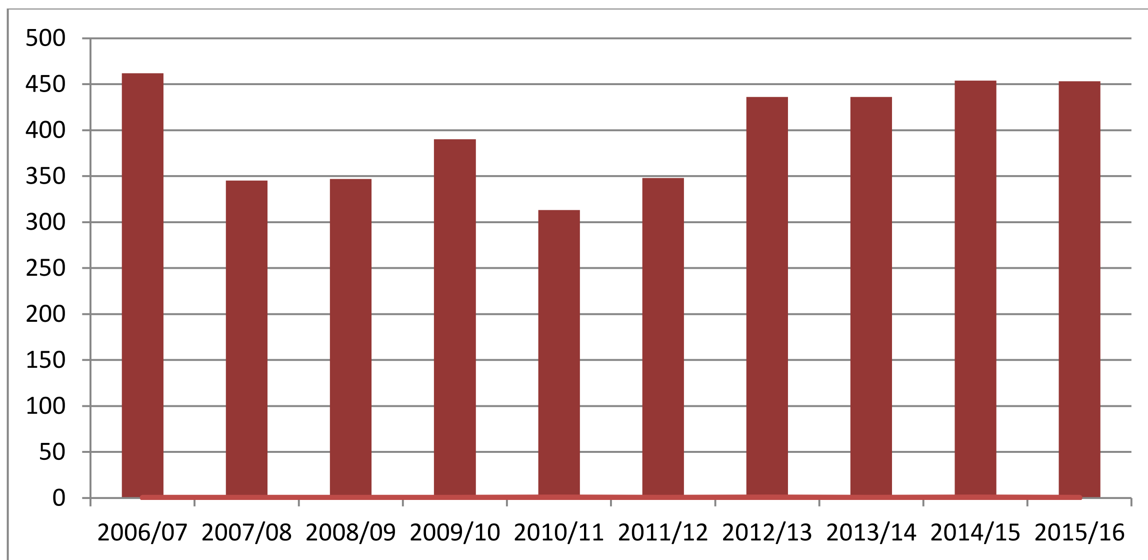
Complaint volumes

19. We have also considered whether we can estimate the impact our proposals will have on the number of pension transfer complaints. We have found difficulties doing this.

20. As explained, we do not receive specific pension transfer complaints data from firms. The Financial Ombudsman Service records information about the pension transfer complaints that it has received, but this may include a small proportion of complaints that relate to opt-outs.

21. We have reviewed the past volumes of relevant complaints made to the Financial Ombudsman Service to consider the scale and whether the data could be used to forecast the future level of complaints following our proposed changes.

Figure 1: Complaints about pension transfers recorded by the Financial Ombudsman Service from 2006/07 to 2015/16



Source: Financial Ombudsman Service

22. Data from the Financial Ombudsman Service suggest that over the last ten financial years, the average number of new pension transfer complaints is approximately 400 per annum. The Financial Ombudsman Service has explained that this includes cases that were looked into as part of the Pensions Review. Of these complaints, on average approximately 40% were upheld in favour of the consumer. Excluding cases that fall within the Pensions Review, approximately 60% of cases were upheld in favour of the consumer. We estimate that the Financial Ombudsman Service receives between 5% and 15% of all the complaints made to

firms that we regulate[24]. Based on these data, if complaint volumes remained at the current level after the outcome of this consultation, there may be between around 2,700 and 8,000 pension transfer complaints to firms each financial year. Of these complaints, between 1,100 and 3,200 would be successful. Considering the Financial Ombudsman Service's uphold rate and using the figure of £20,000 to £60,000 per redress payment from paragraph 16 (allowing for the caveats in paragraphs 12 and 14), we estimate that under the current methodology the total amount of redress paid is between approximately £22m to £192m per year. However, we note that the uphold rate at the Financial Ombudsman Service may be different to the uphold rate of complaints that are resolved directly between firms and consumers.

23. While the data are helpful for indicating past trends in complaints against regulated firms, we consider the past is only a weak predictor of future complaints. This is because of recent developments across financial services that have made it harder to anticipate consumer behaviour and potential causes for complaint. Specifically:

- the pension freedoms were introduced in 2015, and consumers may increasingly transfer out of their DB pension scheme to make use of the freedoms, and

- the outcomes of the Financial Advice Market Review (FAMR) were published in 2016, and changes to the advice market may reduce or increase the likelihood of complaints

24. Due to the uncertainty introduced by these factors, the number of complaints may increase or decrease.

25. As well as the changes that may affect complaint volumes, we recognise that this consultation and implementing any proposed changes could raise consumer awareness about pension transfers and potential causes for complaint. This may encourage consumers who have been advised to transfer out of their DB pension scheme to make a complaint which could lead to some of these consumers receiving redress. An increase in complaints would result in a higher overall redress bill for firms, and firms may incur administrative costs as a result of handling a higher volume of complaints. In principle, the possibility of a higher redress cost for a successful mis-selling complaint might provide a disincentive for firms to give unsuitable advice.

Compliance

26. Our proposal to make amendments to the methodology will require changes to the existing redress calculator software. We consider this to be more cost effective than implementing a new methodology which would require new software.

27. We have consulted with industry experts on the practicalities of amending the software used to calculate redress for the current methodology. They have suggested that our proposed changes are unlikely to result in extensive changes to the software, and that it would be likely to take a few months to make the necessary amendments.

28. We recognise that firms have not been able to settle complaints on a full and final basis since our announcement to consult, and that amending the methodology and relevant software will add to the delay in settling complaints.

29. We consider the period of delay to be necessary for us to intervene to secure consumer protection. We also consider our proposal to be the best option, out of all the options that we

[24] We have estimated this range using data that the FCA and ombudsman service has published about complaint volumes.

proposed in Chapter 3. This is because it will result in the appropriate and immediate settlement of complaints, and will bring the least amount of disruption for firms. Our proposal to review the methodology on a regular basis means that firms may have to incur future costs to comply with any further changes to the methodology to ensure that it continues to meet its objective. However, this proposal will ensure that consumers are more likely to continue to receive appropriate redress.

Overall conclusion for CBA

30. We estimate that firms receive between 2,700 and 8,000 pension transfer complaints each year, and that under the current redress methodology the average redress is approximately £20,000 to £60,000 per complaint.[25] While we do not know the uphold rate across all of these complaints, data from the Financial Ombudsman Service suggests that it upholds 40% of all pension transfer complaints that it receives.

31. Our proposal is likely to increase the overall redress bill because it is likely to increase the value of an individual's DB pension scheme for the purpose of the redress calculation. The redress represents a transfer from firms to consumers by amending the current methodology so that the consumers are more likely to be put back into the position that they would have been in if they had not received unsuitable advice to transfer out of their DB pension scheme, so we are fulfilling the FCA's objective of consumer protection.

32. For the reasons set out above, we have not gathered the data required to quantify the precise impact of the change and how it may affect complaint volumes. The examples that PwC has provided show that our proposed methodology will increase the value of the DB pension scheme for a consumer with 2 years until retirement by 7.3% and the value of the DB pension scheme for a consumer with 15 years until retirement by 20.2%. However, we cannot calculate the effect on redress without knowing the size of the average DB pension scheme or the personal pension.

33. The proposal will also have minor indirect costs. These include costs of changes to the software used to calculate redress payments; and costs resulting from a short term delay to settling claims while these changes are made.

Q23: Based on your experience with these complaints, what do you think the cost of updating the existing methodology will be, and how will our proposals impact redress payments? Please provide evidence.

Q24: Do you agree with the issues that we have identified in our CBA? Are there any further issues that we should consider?

[25] See Annex 2 paragraph 22

Annex 3 List of questions

Q1: Do you agree with our proposal for the basis of the redress calculation methodology? If not, what approach do you consider we should take and why?

Q2: Do you agree with our approach to valuing the DB pension scheme benefits? If not, do you agree with the alternative approach or do you consider a different method would work better?

Q3: Do you agree with our proposal for the inflation rate assumption to be used in the methodology? If not, what rate should be applied and why?

Q4: Do you agree with our proposal for the pre-retirement discount rate to be used in the methodology? If not, what approach do you consider should be used and why?

Q5: Do you agree that there should be one approach to the pre-retirement discount rate applied to all consumers? If not, how should the other rates be determined?

Q6: Do you agree that the same pre-retirement discount rate proposed for DB pension scheme benefits should be used for PPF benefits? If not, what rate should be applied and why?

Q7: Do you agree with our proposal for valuing personal pension charges in the methodology? If not, what approach should be taken and why?

Q8: Do you agree with our proposal for the post retirement discount rate to be used in the methodology? If not, what approach should be applied and why?

Q9: Do you agree with the 0.6% deduction to reflect pricing models used by annuity providers?

Q10: Do you agree that the pension methodology should take account of the pension commencement lump sum?

Q11: If so, do you agree with the approach and the rate proposed to account for this? If not, what approach should be applied and why?

Q12: Do you agree with our proposal to use PxA08 mortality tables adjusted for future mortality improvements? If not, what approach should be used and why?

Q13: Do you agree with our gender-neutral approach to mortality in the methodology? If not, what approach should be used and why?

Q14: Do you agree with our proposal to assume that consumers are the same age as their spouse? If not, what approach do you think should be used and why?

Q15: Do you agree with the proposed methodology for assessing the likelihood of consumers being married or in a civil partnership at retirement? If not, what approach should be applied, and why?

Q16: Do you agree with the proposed methodology for valuing enhancements to the transfer values? If not, what approach should be applied and why?

Q17: Do you agree that firms should update the relevant assumptions on a quarterly basis? If not, please tell us why.

Q18: Do you agree with our approach to reviewing the methodology? If not, please tell us why.

Q19: Do you think that our proposed redress methodology should be applied to complaints relating to non-joiners, opt-outs and FSAVC cases? If yes, why? If not, how should redress for these cases be calculated and why? For example, should any adjustments be made so that the proposed methodology can be used for these cases? Should the current methodology continue to be used for these cases?

Q20: Do you think that our proposed redress methodology should be applied to complaints relating to transfer of other safeguarded benefits? If yes, why? If not, how should we redress for these to be calculated and why? Is there a need to differentiate between different types of safeguarded benefits?

Q21: Do you agree with our proposed approach to the impact of tax on redress payments?

Q22: Are there any other aspects of the existing methodology that we have not covered in this paper that need to be updated? If so, what changes do you consider need to be made?

Q23: Based on your experience with these complaints, what do you think the cost of updating the existing methodology will be and how will our proposals impact redress payments? Please provide evidence.

Q24: Do you agree with the issues that we have identified in our CBA? Are there any further issues that we should consider?

Annex 4 Compatibility statement

1. This Annex explains our reasons for concluding that our proposals in this consultation are compatible with certain requirements under FMSA, the Equality Act 2010 and the Legislative and Regulatory Reform Act 2006 (LRAA).

The FCA's objectives and regulatory principles

2. Section 1B of FSMA requires us, when discharging its general functions (such as giving general guidance), to act in a way, so far is reasonably possible, that is compatible with its strategic objective, and advances one or more of its operational objectives. We must also, so far as is compatible with acting in a way that advances the consumer protection objective or the integrity objective, carry out our general functions in a way that promotes effective competition in the interests of consumers. Our general functions include functions in relation to issuing guidance.

3. We believe the proposals set out in this paper are compatible with our duties under section 1B of FSMA. Our guidance on the pension transfer redress methodology gives consumers a greater chance of receiving appropriate and consistent redress. This advances our objective of consumer protection.

4. We have had regard to the regulatory principles set out in section 3B of FSMA. In formulating the proposal, we have adhered to the principles of transparency and proportionality. We have been transparent in stating our intention to consult on changes to the current redress methodology as there may be more appropriate ways to calculate redress for consumers following unsuitable advice. The proposed redress methodology is proportionate because it contributes to a better regulatory outcome as consumers will be more likely to receive appropriate redress.

Compatibility with the duty to promote effective competition in the interest of consumers

5. In preparing the proposals as set out in this consultation, we have had regard to our duty to promote effective competition in the interests of consumers. We do not consider there to be any competition implications to the pension redress methodology proposed in this paper.

Equality and diversity

6. In exercising our functions, we are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and other prohibited conduct, and to advance equality of opportunity and foster good relations between persons who share relevant protected characteristics and persons who do not. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.

7. We give the outcome of the assessment in this case in Chapter 1 of this paper.

Legislative and Regulatory Reform Act 2006 (LRRA)

8. Under the LRRA we are subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules).

9. We have had regard to the principles in the LRRA and the Regulator's Code for the parts of the proposals that consist of general policies, principles or guidance and consider that the proposals are proportionate and result in an appropriate level of consumer protection. We have been transparent with external stakeholders as far as possible by informing them of our intention to consult.