Deloitte.

Financial Conduct Authority

Periodic Review of Defined Benefit Pension Transfer Redress Guidance – Technical Report

JULY 2022

MAKING AN IMPACT THAT MATTERS since 1845

Contents

Executive Summary

Executive Summary

The FCA has asked us to perform a review of the methodology and assumptions underlying the calculation of redress for unsuitable defined benefit pension transfer advice. This includes a review of the FG 17/9 Guidance entitled "Guidance for firms on how to calculate redress for unsuitable defined benefit pension transfers".

The FCA has set out 11 key objectives for the redress methodology and assumptions which are set out in Section 2 of this Report. Ultimately any changes to the methodology are an FCA policy decision.

The updated basic objective of redress, as set by the FCA, is that appropriate redress must, as far as possible, put the consumer into the position they would have been in if they had received compliant advice. As per our scope, consideration of whether the basic objective is appropriate did not form part of our review.

A range of possible approaches that could be adopted in respect of calculating redress have been considered, along with the wider implications of adopting them. Based on meeting the FCA's objectives, we have concluded that **the current approach of calculating redress as a lump sum amount remains an appropriate approach**.

In the context of redress being calculated as a lump sum we have considered how this payment could be made. Where it is possible to pay redress into a consumer's DC pension (and not be impacted by the various tax issues), this is the most appropriate approach to meet the FCA's objectives. It is acknowledged that this will not be possible in the majority of redress cases. In these cases, and based on the FCA's objectives, **we consider that paying redress as a cash amount to the consumer would be a pragmatic alternative** and consistent with the current approach. It is acknowledged that there are limitations associated with providing redress as a cash lump sum and these are discussed within this Report.

The advantages and challenges associated with other approaches, compared to the FCA's objectives, in particular requiring Redress Providers to purchase an annuity for the consumer to replicate the DB scheme benefits, are discussed within this Report.

Consideration has been given to whether the methodology should be based on assuming the consumer purchases an annuity at retirement or that they utilise drawdown. We have concluded that **retaining the current approach of basing the redress methodology on assumed annuity purchase remains an appropriate approach**, based on the FCA's objectives.

We have considered the key assumptions (financial and demographic) underlying the current redress methodology and propose some changes to better meet the FCA's objectives. These proposals for the FCA's consideration include:

- Pre-retirement discount rate: Maintaining an approach based on an assumed 50% of the return on equities, but **making updates to each individual element of the calculation formula** to better reflect the current economic environment and to reduce volatility.
- Inflation & Inflation linked: **Introducing an Inflation Risk Premium** into the setting of RPI inflation and proposing the use of a **Black Scholes model** to derive pension increase assumptions.
- Proportion Married/In Civil Partnership: Replacing the current single assumption of 85% married for Prospective Loss cases with **a table of proportion married/in civil partnership percentages** based on a consumer's actual marital/civil partnership status at Date of Calculation and their term to assumed retirement age.
- Charges: Introducing **a consistent approach for product/fund charges and ongoing adviser charges**.

Practical aspects of redress calculations relating to the date of calculation, timescales for issuing redress offers and applying interest up to the date of settlement are discussed in this Report.

Executive Summary

As per our agreed scope, the following have also been considered in this Report:

- Actual Loss cases and the need for additional guidance in light of the changes to the pensions landscape since the Pension Review, in particular the introduction of freedom and choice post April 2015. The 2016-17 review of the redress methodology was undertaken before the full impact of these changes on consumer behaviour had been seen.

- The definition of 'retired' in the context of defining a case as Actual Loss and we have set out a range of options for consideration. **It is ultimately an FCA policy decision in respect of the approach to be proposed and consulted on for Actual Loss.**

- A number of practical aspects of Actual Loss calculations and proposals on areas to clarify in any revised redress methodology produced by the FCA. This includes:

  - Assuming that consumers commute the HMRC maximum from the DB scheme, other than in a limited number of defined scenarios;

  - Requiring past payments (Past Loss) to be increased from date of payment to Date of Calculation in line with the Bank of England Base Rate over the period; and

  - Specifying default Early Retirement, Late Retirement and PCLS factors where these are not available from the DB scheme.

- The extent to which the SERPS adjustment remains appropriate in light of the changes to State Pensions post April 2016. Based on information provided by the DWP:

  - Any revised redress methodology produced by the FCA should state that **no SERPS adjustment should apply in respect of transfers post 6 April 2016.**

  - For transfers pre 6 April 2016, detailed information on the individual's state pension calculation will be required from the DWP.

In undertaking this review we acknowledge that, by its nature, an industry wide redress methodology based on a range of assumptions has inherent limitations. The redress methodology needs to be applicable and consistent across a wide range of consumers. It needs to be applicable for different schemes, different advisers, different characteristics and be practical to implement and where possible, future proofed.

The amendments proposed for the FCA's consideration are not designed to specifically increase or decrease the ultimate redress amount, but rather to improve the robustness of the approach and more closely align the redress methodology to the FCA's stated objectives, when considered individually and as a whole.

The proposals have been based on a combination of general assumptions considered appropriate for the whole population and consumer specific assumptions reflecting individual circumstances.

We have proposed consumer specific assumptions where they are feasible, practical and align with the FCA's stated objectives. Where general assumptions are adopted, there are likely to be some consumers who receive a different level of redress compared to if consumer specific assumptions were adopted for all elements of the redress methodology.

Throughout this report, the proposals have been made in the context of meeting the FCA's 11 stated objectives, whilst acknowledging that there is often a balance to be struck between competing objectives. The final decision will be an FCA policy decision.

Scope of Review

Scope of our Review

Scope and Purpose

This Report is made by Deloitte Total Reward and Benefits Limited ("DTRB" or "us") solely to the Financial Conduct Authority ("you" or the "FCA") pursuant to terms of engagement dated 4 January 2022 and agreed by the FCA and DTRB. This Report is the 'Technical Report' mentioned in those agreed terms. Our work has been undertaken and this Report has been prepared so that we might state to the FCA those matters we have agreed to state to them in this Report and for no other purpose.

Without assuming or accepting any responsibility or liability in respect of this Report to any party other than the FCA, we acknowledge that the FCA may choose to make this Report publicly available for others wishing to have access to it (including consumers, financial advisers, pensions advisers, tax advisers, and other interested parties), which does not and will not affect or extend for any purpose or on any basis our responsibilities. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the FCA for our work, for this Report, or for any conclusions, opinions or proposals we have formed or made.

The FCA has asked us to perform a review of the methodology and assumptions underlying the calculations of redress for unsuitable defined benefit pension transfer advice. This includes a review of the FG 17/9 Guidance entitled "Guidance for firms on how to calculate redress for unsuitable defined benefit pension transfers". The FCA has set out 11 key objectives for the redress methodology and assumptions which are set out in Section 2 of this Report.

We understand that this Report will be used by the FCA as a basis to form a consultation on FG 17/9 and the associated redress calculation methodology and assumptions. Within this Report we make a number of proposals for changes to the redress methodology and assumptions for the FCA to consider. We make these proposals based on our understanding of the objectives of the FCA and the FCA's stated purpose of the redress methodology.

We have therefore prepared this Report to support the FCA in its formal review of the redress methodology.

Cases relating to transfers from a Defined Benefit (DB) to a Defined Contribution (DC) pension scheme, non-joiners, opt-outs and FSAVC cases are covered by the FG 17/9 Guidance and are therefore covered by this Report.

Only the areas of the redress methodology specifically covered in this Report have been reviewed. Any areas/ aspects of the redress methodology not covered in this Report have not been reviewed. If you identify any other areas of the redress methodology you would like us to consider we would be happy to review these separately.

This Report has been prepared in the knowledge that the FCA will review and analyse our proposals and consider whether it is necessary to make any changes to the existing redress methodology. We understand that our proposals may be accepted or rejected by the FCA, in whole or in part.

The FCA will retain ultimate responsibility for determining the methodology and assumptions for future redress calculations, as well as undertaking any necessary consultations with its stakeholders. In constructing the final redress methodology, we expect the FCA will need to consider a number of legal and policy decisions which are beyond the scope of this Report.

Technical Actuarial and Professional Standards

This Report has been prepared in accordance with "Technical Actuarial Standard 100" (TAS 100) as issued by the Financial Reporting Council and peer reviewed in accordance with Actuarial Professional Standard X2.

Scope of our Review

Limitations

The following limitations of the scope of the review should be noted:

- The scope of our review relates to the calculation of redress for cases where it has been deemed that a redress calculation is required (due to unsuitable advice). Our review does not consider why such advice was unsuitable.
- Consideration of whether the basic objective of redress is appropriate was not within the scope of our review.
- Our proposals are based on the redress methodology applying for all relevant cases in the market going forwards. This is based on the assumption that consumers receiving redress will have varying characteristics (including in relation to varied DB schemes and receiving schemes). If there were to be a large number of cases of a similar nature (for example the FCA's proposed redress scheme in relation to transfers out of the British Steel Pension Scheme), we would recommend that the FCA review the approach to calculate redress to make sure it adequately reflects the specific circumstances of that situation.
- We have not performed a full cost-benefit analysis of our proposals. It remains the FCA's responsibility to assess the costs and benefits of any changes to the redress methodology.
- The review and proposals contained in this Report are based on market conditions and our understanding of legislative and regulatory requirements as at the date of writing this Report. Market conditions are volatile, and the financial impact of any changes to the assumptions covered in this Report will be impacted by this volatility. If there are material changes to market conditions, the proposals in this Report may need to be reviewed and revised again in the future. Where applicable, proposals have been made on the frequency of review (and triggers for review) of aspects of the methodology and assumptions.
- Unless noted otherwise, calculations contained in this Report have been undertaken as at 1 April 2022. The same calculations undertaken at a different date may have produced different results.
- The example consumer calculations shown in this Report are for illustrative purposes only. They are not intended to represent any particular real-life consumers. Although the cases chosen illustrate realistic DB scheme benefit scenarios, the actual amounts chosen are arbitrary and no particular significance should be attached to them. Actual redress calculations will ultimately depend on the specific DB scheme benefits, the actual receiving product/ fund and the personal circumstances of the consumer.
- Nothing contained within this Report constitutes or should be considered as legal, investment or tax advice. In particular, consideration of the tax implications of the payment of redress (either into a personal pension or as a cash lump sum) are excluded from the scope of our work. The FCA may wish to obtain specialist tax advice in respect of this for inclusion as part of the consultation.
- Our analysis is based on the impact on a consumer's retirement benefits. We have not considered the impact on other benefits or obligations which consumers may have (such as the impact on means-tested benefits) as this is outside the scope of this Report.
- Only the areas of the redress methodology specifically covered in this Report have been reviewed by us. Any areas/ aspects of the redress methodology not covered in this Report have not been reviewed.

Scope of our Review

Sources of Data

In undertaking the review we have relied on the following key sources of data:

- "Finalised guidance – Guidance for firms on how to calculate redress for unsuitable defined benefit pension transfers" dated October 2017 (updated March 2022) ("FG 17/9 Guidance")
- "Analysis and recommendations for the impact of RPI reform on the redress approach and guidance" produced by PwC dated March 2021 ("the PwC Report")
- "Guidance consultation – GC17/1 – Changes to the way firms calculate redress for unsuitable defined benefit pension transfers" dated March 2017 ("the 2017 Consultation")
- FCA publication on the summary of feedback received from the GC17/1 consultation, dated October 2017
- Non-confidential responses received by the FCA on the GC17/1 consultation provided by the FCA on 5 January 2022
- Archive of pension review documents provided by the FCA on 5 January 2022

We have also sourced other documents/publications as necessary for our review. Where relevant these are referenced within this Report.

We have not audited the data, but have taken reasonable steps to satisfy ourselves that the data is of adequate quality for the purpose of this Report. We are satisfied with the internal consistency of the data, but cannot accept any responsibility for errors or omissions in the underlying data.

We have discussed our initial findings and views with the FCA on weekly calls and incorporated the outcomes of our discussions within our proposals for this Report. Discussions were also held with FOS and DWP in respect of certain aspects of the methodology.

Scope of our Review

Overview of Report

This Report covers a wide range of areas relating to the current redress methodology. We have summarised below the areas covered in each section of this Report.

- **1. Background:** This section sets out context to the review and the principles which this review is based on. We discuss the background to the Pension Review to provide context to the current FG 17/9 Guidance and consider how market conditions have changed since the 2017 Consultation.
- **2. Key objectives and approach:** This section sets out the FCA's 11 stated objectives for the redress methodology. We set out an overview of our approach to the review and discuss mechanisms for reviewing aspects of the redress methodology in the future.
- **3. Possible approaches to calculating redress:** This section looks at the fundamental question in respect of the approach to redress. We consider a range of possible approaches that could be adopted in respect of calculating redress along with the wider implications of adopting them.
- **4. Overall redress methodology**: Based on the FCA's objectives, the proposal in the 'Possible approaches to calculating redress' section is that the current approach of calculating redress as a lump sum amount remains appropriate. This section considers whether the methodology should be based on assuming the consumer purchases an annuity at retirement or that they utilise drawdown.
- **5. Assumptions & methodology analysis:** This section contains analysis and proposals in respect of the key assumptions of the redress methodology. This includes:
  - Pre-retirement discount rate, Post-retirement discount rate (including PCLS), Inflation and inflation linked, Demographics, Charges, Calculation date and frequency of updates and other aspects of the methodology not covered in previous sections.
- **6. Actual Loss:** This section considers the approach to Actual Loss cases and potential changes/ additions to the redress methodology in light of the changes to the pensions landscape since the Pension Review, in particular the introduction of freedom and choice post April 2015. We set out analysis and proposals in respect of the approach to Actual Loss cases.
- **7. SERPS adjustment:** This section considers the SERPS adjustment and the extent to which it remains appropriate in light of the changes to State Pensions post April 2016.
- **8. Conclusion:** This section summarises the proposed changes to the current redress methodology. This also considers key information for disclosure to consumers as part of redress offers.
- **9. Example consumers:** This section summarises the potential impact of the proposed changes to the redress methodology on the redress payable to a range of example consumers.

1. Background

Background

The basis of our review

Background

The FCA is undertaking a review of the defined benefit pension transfer redress methodology and its accompanying FCA Guidance (FG 17/9) to consider whether they meet the FCA's stated objectives as set out in Section 2 (Key Objectives and Approach) of this Report.

Cases relating to transfers from a Defined Benefit (DB) to a Defined Contribution (DC) pension scheme, non-joiners, opt-outs and FSAVC cases are covered by this guidance and are therefore covered by this Report.

Throughout this Report, we typically discuss the methodology and assumptions in the context of transfer cases as these are the most prevalent redress case types in the market. However, the assumptions in this Report should also be relevant to non-joiners, opt-outs and FSAVC cases. We have specifically commented on these other case types within this Report where appropriate.

We acknowledge that this review is important to the FCA and the wider pension transfer advice market (including Redress Providers currently undertaking redress calculations), particularly given the FCA's on-going supervisory work in this area, the FCA's market wide findings relating to the suitability of DB pension transfer advice and the past business review/ remediation work that is currently underway in the market.

The basic objective of redress

As stated in FG 17/9 paragraph 4, where a firm or adviser has failed to give compliant and proper advice, or has committed some other breach, the basic objective of redress is:

> *to put the consumer, 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*.

During the course of our review, the FCA has updated the basic objective of redress to be as follows:

> *Appropriate redress must, as far as possible, put the consumer into the position they would have been in if they had received compliant advice.*

This over-riding principle is central to this review.

Key principles of the review

Against this backdrop, based on the FCA's stated objectives, and our understanding of the current legislative and regulatory landscape, key principles of this review, which we have discussed with the FCA, include:

- Robustness: Developing a redress methodology that is robust in terms of the approach, limiting the need for it to be reviewed/updated in the future.
- Removing ambiguity: There are some aspects of the current methodology that may leave too much room for interpretation across Redress Providers undertaking calculations, leading to inconsistent approaches, and where a more directive approach may be appropriate (in particular relating to Actual loss cases and the SERPS adjustment).
- Practicalities: When developing a redress methodology there is naturally a trade-off between the practicalities of any approach relative to accuracy on a case by case basis. Where relevant we have considered the practicalities of the approach from a data gathering, time, cost and third party software update perspective.

The selected method to calculate redress needs to be applicable and consistent across a wide range of consumers. It needs to be applicable for different schemes, different advisers, different characteristics and be feasible, practical and future proofed.

Where exact replication of the consumer's original DB scheme benefits is not possible, the selected approach should not seek to be overly penal or overly favourable to either the consumer or the Redress Provider.

Background

The current approach

The Pension Review

In 1994, the industry regulator at the time (the Securities and Investment Board (the SIB)) established the Pension Review amid concerns about the mis-selling of personal pension policies. The review looked at sales of personal pension policies between 29 April 1988 and 30 June 1994.

As part of the Pension Review, the SIB published a number of documents providing detailed guidance on how redress calculations should be undertaken relating to DB transfers, opt-outs and non-joiners. Updates to the redress methodology and the assumptions underpinning the calculations have been made by the relevant regulatory bodies over the years since then. However, the SIB documentation from the Pension Review still provides the foundation of the approach adopted by Redress Providers for the calculation of redress.

The current approach

The current redress approach is outlined in the FG 17/9 Guidance which was released in October 2017 following a review by PwC and subsequent consultation.

FG 17/9 does not cover all areas of redress calculations. As set out in FG 17/9, for all areas not covered by FG 17/9: *pension transfer 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 (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.* In simple terms, where FG 17/9 does not set out an approach, the previous methodology as set out in the relevant previous publications applies.

This current approach requires the comparison of the value of the consumer's benefits in the DB pension scheme (as if the consumer had not transferred) to the value of benefits in the DC pension arrangement.

The approach requires the calculation of the value of a lump sum that if assumed to be invested in the consumer's personal pension, should enable the value of the personal pension to reach a size at retirement that enables the consumer to acquire the same benefits, including a guaranteed lifetime income, as they would have received from their DB pension scheme and any other benefits that would have been payable from the DB scheme (e.g. spousal benefits).

On 1 September 2021 the FCA issued a statement in respect of FG 17/9 which set out some clarifications on how Redress Providers should be applying or interpreting the guidance in certain areas.

Actual Loss and Prospective Loss

The Pension Review defined two categories of cases: Actual Loss and Prospective Loss. FG 17/9 also makes reference to these case types. The SIB documentation from the Pension Review defines these categories as follows:

- **Prospective Loss:** Where the consumer (or their spouse or dependants) are exposed to the probability of an actual financial loss when an event such as death or retirement occurs in the future.
- **Actual Loss:** When an event (such as death or retirement) has already occurred giving rise to benefits and the benefits from the personal pension are less than those the occupational scheme would have conferred.

FG 17/9 simply defines Actual Loss as occurring when the consumer has retired, died or both.

In summary, under the current FG 17/9 Guidance, Prospective Loss cases relate to consumers who are not yet retired or dead. Actual Loss cases relate to consumers who are retired or dead.

In Section 6 (Actual Loss) of this Report we discuss the considerations in respect of the definition of Actual Loss and in particular the definition of 'retired' in this context.

Background

Changes in market conditions

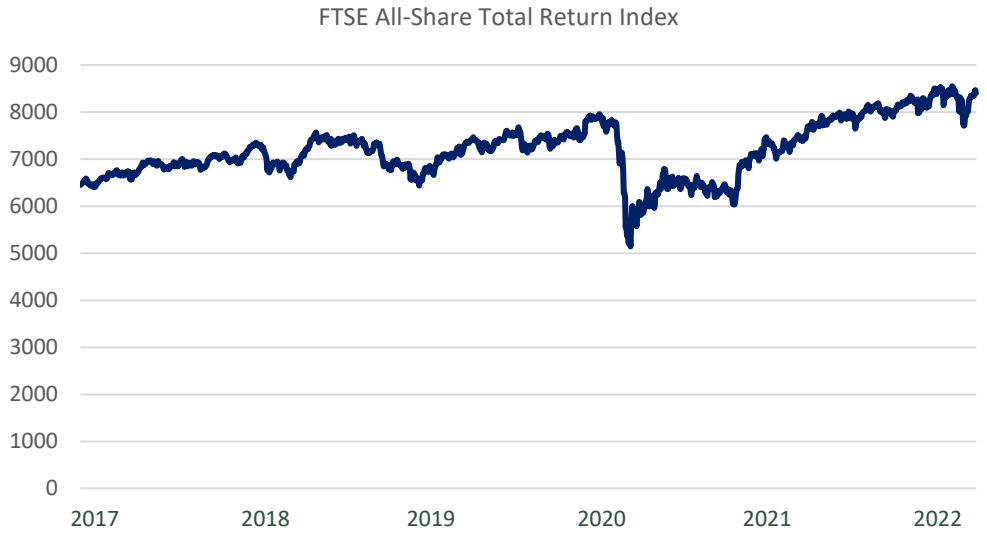
Since the 2017 Consultation and subsequent introduction of FG 17/9, there have been major global and national events having a material impact on financial markets. Financial markets have seen significant volatility over this time, with the emerging trends in equity, gilt and inflation markets shown in the graphs on the right.

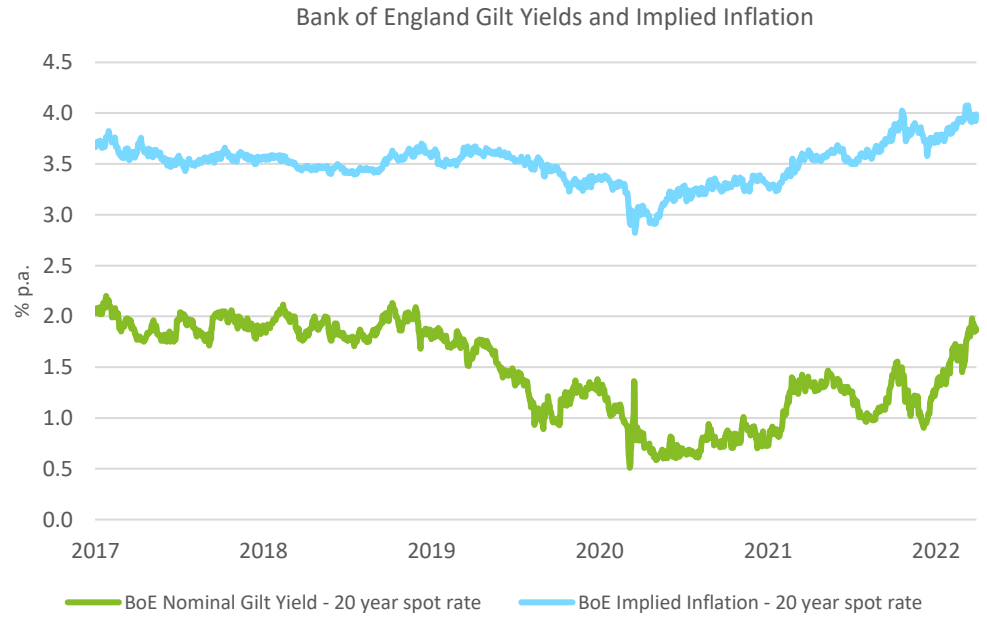
These volatile market conditions will have resulted in material differences in the amount of redress calculated under the current methodology depending on the calculation date used and the investment make-up of a consumer's DC fund. The emerging impact of the COVID-19 pandemic in 2020 in particular led to significant changes in financial conditions at the time as can be seen by the sharp changes in the graphs in early 2020.

These changes in market conditions do not necessarily lead to a need to make any fundamental changes to the approach for setting assumptions for redress calculations, however the volatility experienced highlights the need for a robust and future proofed approach to assumptions setting as far as is possible. It also highlights the importance of the DB benefits and DC benefits being valued on the same day (i.e. based on the same market conditions).

The DC pensions market has continued to grow over recent years with consumers able to access a wide range of different options for their retirement provision.

Consumers have continued to access their benefits from DC schemes flexibly with the FCA's research[1] published in December 2021 showing that only 11% of consumers had purchased an annuity the first time they accessed their benefits over the period April 2018 to March 2021. Drawdown and full commutation have become popular options, although this varies depending on the consumer's DC fund size.





[1] www.fca.org.uk/data/retirement-income-market-data-2020-21

2. Key Objectives and Approach

Key Objectives and Approach

11 Key FCA Objectives

The FCA has set out 11 key objectives for the redress methodology which are shown in the table below (and on the next page).

Some of these objectives will more prominently apply to certain aspects of the methodology/assumption than others. Within this Report we have set out the objectives we consider to be the most relevant for that particular area of our review. We note that there is the potential for certain FCA objectives to be in conflict with each other (e.g. accuracy vs efficiency and cost). Therefore, where necessary, we have set out in this Report the potential trade-offs between the competing objectives.

No.	Objective
1	To provide a clear and appropriate approach to calculating redress for the following types of complaint, regardless of whether the loss is prospective (i.e. where the pension has not been accessed) or actual (i.e. where the pension has been accessed or the consumer has died): • Complaints received by a firm 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 money purchase arrangement. This might include a personal pension, stakeholder pension, or other defined contribution scheme; • Complaints about a pension transfer between 29 April 1988 and 30 June 1994 in circumstances where either: (i) the firm did not review the relevant pension transaction in accordance with the regulatory standards or requirements applicable for the review of the transaction at the time; or (ii) the particular circumstances of the case were not addressed by those standards; and • Complaints concerning non-joiner, pension opt-outs and Free Standing Additional Voluntary Contributions (FSAVC) pensions.
2	To put a consumer, so far as possible, back in the position they would have been in but for the act or omission by the firm. This should be achieved by providing redress that, if assumed to be invested in their personal pension, should enable the value of the personal pension to reach a size at retirement that enables the consumer to acquire the same benefits, including a guaranteed lifetime income, as they would have received from their defined benefit pension scheme and any other benefits that would have been payable from the DB scheme (e.g. spousal benefits).
3	To recognise that consumers who have been misadvised to transfer out of their DB scheme are likely to have a relatively cautious attitude to investment risk, but, nonetheless, now have the ability to make returns on their investments (and must do so to mitigate losses). Accordingly, the redress methodology and assumptions should achieve an appropriate balance between the additional downside risks that consumers are now exposed to in a DC scheme with the upside risk that consumers' pension investments 'outperform' the assumptions and consumers are, therefore, overcompensated.

Key Objectives and Approach

11 Key FCA Objectives

No.	Objective
4	To reflect current practices for taking benefits from pension schemes they would have been in but for the act or omission by the firm.
5	To take account of factors such as recent and future changes to the pensions landscape, the availability of data, and actuarial standards and best practice to ensure the redress methodology and assumptions are as robust as possible over an extended period of time. This includes, but is not limited to, the impact of the removal of contracting out and changes to the state pension on the State Earnings Related Pension Scheme (SERPS) adjustment. The FCA's current public commitment is to review the guidance every 4 years, however, in future, would prefer for reviews to be triggered by specified events (see objective 11, below).
6	To ensure consistency of approach between firms carrying out the calculation.
7	To ensure clarity and minimise the scope for ambiguity in the application of the methodology and guidance, minimising the risk that the approach to calculating redress can be misinterpreted or manipulated.
8	To allow calculations to be completed efficiently to avoid delays and excessive costs in resolving complaints.
9	To enable those who undertake redress calculations or provide redress software to understand the rationale behind the methodology and assumptions and be able to apply it readily in practice.
10	To ensure key elements of the redress calculation to be transparent and explainable to consumers.
11	To minimise the need for the FCA to update the methodology and assumptions or elements of them regularly to ensure that they remain appropriate, for example in response to significant changes in competition, pricing, financial markets, consumer behaviour, etc. (and, if this is not possible, to recommend a framework for regular review or trigger points for revision across all relevant variables). This includes, but is not limited to, ways to 'futureproof' the CPI assumption in FG 17/9, which, in its current form, is likely to require annual updating.

As already noted, during the course of our review, the FCA has updated the basic objective of redress to be ***Appropriate redress must, as far as possible, put the consumer into the position they would have been in if they had received compliant advice.*** This updated objective is reflected within our Report.

Key Objectives and Approach

Our Approach to this Review

This review has been undertaken based on the following overall approach as agreed with the FCA:

- Analysing changes to the pensions (economic and regulatory) landscape since the previous 2016-17 review of the redress methodology.
- Considering any known (or potential) upcoming changes to the pensions landscape which could impact the redress methodology going forward, and how this may be 'future proofed'.
- Reviewing each of the individual assumptions (as set out in FG 17/9) used in redress calculations to analyse if the approach to setting them remains appropriate and sufficiently future proofed.
- Reviewing the approach and assumptions used for Actual Loss cases, noting that the current FG 17/9 Guidance primarily focuses on Prospective Loss cases.
- Investigating the impact on a consumer's entitlement to the State Earnings Related Pension Scheme (SERPS) as a result of transferring from a DB scheme to a DC scheme.
- Reviewing and considering the extent to which the indices used for revaluing the funds in FSAVC calculations remain appropriate.
- Considering the additional assumptions/approaches that would be required in respect of opt-outs/ non-joiners cases.
- Investigating other areas of potential ambiguity within the current FG 17/9 Guidance such as GMP Equalisation.

All steps are undertaken with consideration against the FCA's objectives.

This Report constitutes the 'Technical Report', and is accompanied by a 'Technical Manual'. The Technical Manual has been prepared to provide worked examples of the redress calculation process for transfers under the proposed redress methodology as set out in the FCA's Consultation Paper CP22/15. **The content of the Technical Manual is solely based on the FCA's proposed redress methodology set out in the FCA's Consultation Paper CP22/15, the contents of which may differ to the information contained in this Report.**

Within this Report we have provided illustrative examples of redress calculations for a small number of indicative consumers to show the impact of our proposed changes. Details on the example consumers we have considered are set out in Section 9 (Example consumers) of this Report.

Within this Report we have set out some key conclusions and proposals for the FCA to consider as part of the future redress methodology. These have been identified by the light blue shaded boxes.

There are areas where we consider that the FCA may want to have further consultation with the industry before a decision can be made on the appropriate approach to take. We have identified these by the light green shaded boxes.

Details of the proposals and findings of this Report have been shared and discussed with the FCA throughout the project, including during weekly calls. Discussions were also held with FOS and DWP in respect of certain aspects of the methodology. The outcomes of these discussions are reflected in this Report.

Key Objectives and Approach

Future reviews

FCA's objective 11 states:

To minimise the need for the FCA to update the methodology and assumptions or elements of them regularly to ensure that they remain appropriate, for example in response to significant changes in competition, pricing, financial markets, consumer behaviour, etc. (and, if this is not possible, to recommend a framework for regular review or trigger points for revision across all relevant variables).

Within the review we have considered the robustness of the approach to setting individual assumptions and methodologies. This has led to proposals for a future review framework for certain elements.

We consider that the overarching framework should include the following elements:

A full review of the methodology (similar to that being undertaken now) at a prescribed time period

- The addition of review triggers for individual assumptions will help maintain the appropriateness of the key elements of the redress methodology. However, different emerging trends over time and the potential for unforeseen changes to the economic, legislative or regulatory landscape will mean that it is appropriate to include a backstop review date for the whole methodology.
- If interim review triggers lead to numerous reviews being undertaken in the intervening period then the FCA may consider it appropriate to delay the full review of the methodology nearer the time. However we consider it appropriate to set this backstop period now.
- We consider an eight-year period (i.e. in 2030) to be appropriate and consistent with expected changes to RPI inflation by this time.

A time-based interim review for key assumptions

- Certain assumptions are key to the redress methodology and have a material impact on the calculations. Therefore we propose a scheduled review time for these specific assumptions. Whilst the rest of the redress methodology would need to be taken into account as part of these reviews, it would not be necessary to formally review all aspects of the methodology at that time.
- We propose the methodologies for the following assumptions are reviewed prior to 2030:
  - Pre-retirement discount rate: in 4 years (i.e. in 2026)
  - Post-retirement discount rate: in 4 years (i.e. in 2026)
  - Inflation (and inflation related assumptions): in 4 years (i.e. in 2026)

Event based triggers

- Certain events may lead to it being appropriate to consider reviewing aspects of the redress methodology. Specific events could include:
  - changes in relevant legislation;
  - publication of new data;
  - changes in consumer behaviour;
  - changes to the wider pensions market; and
  - major events in wider financial markets.

The proposed review triggers in respect of each aspect of the methodology are set out in the relevant sections of this Report.

3. Possible approaches to calculate redress

Possible approaches to calculate redress

Background

Background

The FCA's basic objective of redress is to, as far as possible, put the consumer into the position they would have been in if they had received compliant advice. The redress methodology in this Report relates to the scenario where a consumer transferred and compliant advice would have been to remain in the original DB scheme.

There are various approaches that could be used to calculate redress that could be considered to achieve this objective.

The existing approach is outlined in the current FG 17/9 Guidance. The approach requires the comparison of the value of the consumer's benefits in the DB pension scheme (as if the consumer had not transferred) to the value of benefits in the DC pension arrangement. The difference between these two values forms the redress amount.

The FCA's objective is that this lump sum, if assumed to be invested in the consumer's personal pension, should enable the value of the personal pension to reach a size at retirement that enables the consumer to acquire the same benefits, including a guaranteed lifetime income, as they would have received from their DB pension scheme and any other benefits that would have been payable from the DB scheme (e.g. spousal benefits).

Other approaches exist which could also be used to calculate redress.

Possible approaches

In this Report, after discussion with the FCA, we have considered the following four possible approaches:

- Approach 1: Reinstatement into the original DB Scheme
- Approach 2: Purchase of a deferred annuity for Prospective Loss cases (current annuity for Actual Loss cases) to replicate the original DB scheme benefits
- Approach 3: To require the Redress Provider to provide a guarantee to the consumer (i.e. underwrite) that they will receive the benefits they would have been entitled to in the DB scheme
- Approach 4: Lump sum redress representing the difference between original DB scheme & new DC scheme benefits (the current approach)

Wider considerations

The selected method to calculate redress needs to be applicable and consistent across a wide range of consumers. It needs to be applicable for different DB schemes, different receiving products/ funds, different advisers, different consumer characteristics and be feasible, practical and future proofed. Where exact replication of the consumer's original DB scheme's benefits is not possible, the selected approach should not be overly penal or overly favourable to either the consumer or the Redress Provider.

It may be appropriate to consider different approaches for Prospective Loss and Actual Loss cases. For example an approach of an immediate annuity being bought for the consumer to replicate the DB benefits rather than providing a lump sum of the actuarial equivalent value. Considerations in respect of this approach are set out in Section 6 (Actual Loss) of this Report.

There are other potential approaches to redress (in addition to the four approaches listed) including different forms of guarantees being provided (such as the use of escrow accounts to trigger payments at the point of a consumer's retirement if the benefits they are able to purchase are insufficient). In addition to a number of the limitations listed on the following pages, these approaches introduce additional challenges such as additional oversight of escrow accounts and how to allow for changes in the consumer's retirement plans. We do not consider that these alternative options meet the FCA's objectives and so have not considered them further in this Report.

Possible approaches to calculate redress

Approach 1 – Reinstatement into original DB scheme

Background

Under this approach, the consumer would be reinstated into the original DB scheme, therefore directly putting the consumer back into the position they would have been in had they received compliant advice to remain.

This approach best meets the basic objective of redress and would provide a solution which is equitable across consumers. This approach would be transparent and easily explained to the consumer.

Considerations of approach

- Reinstatement has historically been regarded as one of "the normal methods of redress" as per the "SIB Pension Transfers and Opt-Outs Review of Past Business Part II Specification of Standards and Procedures". However this was based on the pensions landscape at the time. Due to changes in market conditions and the pensions landscape since the Pension Review, this approach is unlikely to be feasible or practical for the majority of cases.

- Since the Pension Review, the majority of DB schemes are now closed to new members (c.90% based on data from the Pensions Regulator[1]) and companies (and trustees) are increasingly unwilling to reinstate benefits. This approach is therefore not considered a feasible option in practice.

- We understand that the FCA has no legal powers to mandate that DB schemes reinstate members. Unless new legal requirements are introduced, DB schemes cannot be forced to reinstate members, and may not even be in a position to do so due to the scheme already being wound up or in the Pension Protection Fund (PPF).

- This approach is likely to introduce high levels of legal complexity in determining who the sponsoring employer would be and the funding of these reinstated benefits going forward. The calculation of the amount of money to be paid into the DB scheme to fund the reinstated benefits would also need to be determined. This is likely to be subjective and depend on the level of prudence in the DB schemes' underlying funding approach. Significant costs and negotiations over a lengthy period of time may be required to agree this.

- Based on the above, we do not consider that reinstatement into the original DB scheme would be a viable option for the vast majority of affected consumers. Furthermore, this option would not be sustainable for the longer term with an increasing number of DB schemes closing, being wound up or falling into the PPF as time progresses.

As a result, we do not consider this a practical option for providing redress now or in the future and thus does not meet the FCA's objectives. We have not considered this further as an option for providing redress to consumers.

[1]www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/db-pensions-landscape-2021

Possible approaches to calculate redress

Approach 2 – Purchase of a deferred annuity to replicate the original DB scheme benefits

Background

The commentary that follows is solely in respect of consideration of the purchase of deferred annuities for Prospective Loss cases. For Actual Loss cases, an immediate (rather than deferred) annuity could be purchased. Specific considerations in respect of this approach are contained in Section 6 (Actual Loss) of this Report.

For Prospective Loss cases, this approach would require the Redress Provider to purchase a deferred annuity which accurately replicates (so far as is possible) the benefits the consumer would have received from their original DB scheme. The annuity would be in the consumer's name and they would receive the benefits at retirement or in line with the terms of the agreed contract.

As the level of benefits at retirement would be prescribed, providing redress in this way would remove the investment risk from the consumer, and enable the consumer to receive the same benefits at retirement as they would otherwise have been expected to receive from the original DB scheme.

The coverage provided by the Financial Services Compensation Scheme (FSCS) on deferred annuities would further protect the consumer's benefits.

Where reinstatement into the original DB Scheme is not possible, this approach would be considered to be the next best option to provide the consumer with the same benefits as promised in the original DB scheme and meet the basic objective of redress.

Considerations of approach

- It is unlikely for there to be sufficient availability of such individual deferred annuity policies in the market for all possible benefit structures of DB schemes in scope. As a result it would be difficult to fully replicate the benefits of the original DB scheme in certain cases.
- Even if a suitable deferred annuity policy was available, it would likely be very costly for the Redress Provider, due to the associated insurer profit, risk margins and reserving requirements that go into the pricing of such contracts. This would appear overly penal to the Redress Provider.
- Requiring the use of deferred annuities only in certain circumstances, such as if one was available in the market or the consumer was very close to retirement (theoretically reducing the level of insurer margins present in the pricing) would create a two-tier redress system which would not provide consistency and fairness across all consumers.
- Given the protection offered by the FSCS (which would typically cover 100% of any insurance contract purchased (i.e. the annuity)), this would provide more protection than the consumer originally had within the DB scheme which may have been subject to a reduction (through an explicit reduction if under the original DB scheme's Normal Pension Age or through reduced pension increases) if the scheme was forced to enter the PPF due to sponsor insolvency.
- Assuming a lump sum payment would be required from the Redress Provider to secure the annuity, complications arise when considering how to treat the remainder of the consumer's DC funds. If the consumer cannot be forced to use the remainder to purchase an annuity, then using only the redress amount to do so may make this approach unfeasible.

Overall, the purchase of a deferred annuity to replicate original DB scheme benefits appears to be too beneficial to the consumer, potentially putting them in a better position than what their original DB scheme would have offered, and consequently overly penal to Redress Providers. This approach also has significant practical limitations due to the nature of the individual deferred annuity market. Therefore, we do not believe this is a practical approach to providing redress, nor do we consider it likely that it would become more feasible in the future without significant changes to the insurance market.

Possible approaches to calculate redress

Approach 3 – To require each firm to provide a guarantee to the consumer (i.e. underwrite) that the original DB scheme benefits will be received

Background

Requiring Redress Providers to provide consumers with such a guarantee allows them to receive the original benefit promise they would have been entitled to at retirement, had they not transferred out of their DB scheme due to unsuitable advice, in a similar manner to having been reinstated into their original DB scheme.

If being underwritten by an Insurance Provider then it would ultimately sit with their other liabilities, and provide a level of security covered by other reserving requirements.

This approach provides the consumer with the closest promise for benefits as they originally had and would allow the consumer to retain flexibility and choice in how and when they receive their benefits, something which an externally purchased deferred annuity is unlikely to do.

Considerations of approach

- This approach effectively requires the Redress Provider to provide the consumer with a defined benefit type promise. The guarantee would also have to be provided via a PPF eligible defined pension scheme, otherwise the consumer risks ultimately being paid unacceptably low levels of redress in the event that the Redress Provider was ultimately unable to cover all of its liabilities. Requiring Redress Providers to set up new defined benefit arrangements is not cost effective and is unlikely to produce the best outcome for consumers.
- This approach does not fully settle the complaint, as many elements may change in the future in terms of the existence of the guarantee and its ability to pay out benefits. Indeed the Redress Provider may not exist or be in a position to meet the cost of the guarantee at the point of the consumer taking their benefits. There is therefore the risk that the consumer has to make a second claim for redress in the future if this method fails to redress them appropriately.
- If being underwritten by an Insurance Provider, then this would arguably provide the consumer with greater security than they had in the original DB scheme and potentially over-compensate the consumer.
- Whilst an Insurance Provider may be able to offer this form of promise and give suitable security levels to back it, this would create a two tier redress approach and be open to challenge on what constitutes a 'suitable' Provider that is allowed to take this route. Such an approach could lead to inequitable treatment across consumers with different consumers receiving their redress in different forms. The reasons for this are unlikely to be easily understood. A two tier approach would also introduce additional regulation and guidance requirements on the FCA.
- Such guarantee arrangements would require additional accounting requirements on the Redress Provider and may impact on their other lending, debt or security arrangements.

Generally, we do not consider that this approach would be appropriate to calculate and settle redress in a timely way. This is particularly the case for standalone independent financial advisers (IFAs), as it could involve the Redress Provider being required to pay the redress over many years before the entirety of the complaint is settled, if indeed they are able to meet this cost at that point in the future. It is highly desirable for redress calculations to settle a claim at that point in time to remove any uncertainty about the timing and/ or amount of any future redress.

As a result, we do not consider this a practical option for providing redress now or in the future and we have not considered this further as an option for providing redress to consumers as it is not aligned with the FCA's objectives.

Possible approaches to calculate redress

Approach 4 – Lump sum redress representing the difference between original DB scheme & new DC scheme benefits (the current approach)

Background

This approach involves immediate settlement of the complaint as a lump sum payment, either as cash or into the consumer's DC arrangement. This would remain in line with the current approach used to calculate redress meaning existing software and approaches can be retained and excessive third party costs which would result from any change in approach avoided.

An immediate lump sum payment offers a level of practicality and efficiency arguably missing from the previous three approaches we have considered, therefore meeting the wider objective of a timely settlement that is practical and feasible.

Set at the right levels and using details of the original DB scheme, the lump sum will return the consumer to the position, at a specified point in time, they would have been in had they not transferred (subject to the limitations set out below).

Contribution to a DC pension arrangement or a cash amount?

FG 17/9 paragraph 7 states: *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.* This indicates that the starting point is to consider payment into the consumer's DC arrangement.

In many cases, there will be limitations to the amount of redress that can be paid into a consumer's DC pension as a lump sum without incurring adverse tax impacts. These are due to:

- Annual Allowance implications (and potentially Lifetime Allowance implications) with contributions above these incurring tax charges; and
- The level of a consumer's gross earnings. Contributions in excess of 100% of a consumer's UK taxable earnings would not receive tax relief.

Making allowance for such tax consequences would increase the redress amount payable by Redress Providers with the extra amount being paid as tax rather than directly benefiting the consumer.

Where it is possible to pay redress into a consumer's DC pension and not be impacted by the issues set out, we consider this the most appropriate approach.

However, it is acknowledged that this will not be possible in the majority of redress cases. In these cases, we consider that the redress should be paid as a cash amount to the consumer. This is consistent with the current approach.

We acknowledge there are limitations of paying redress as cash to consumers, in particular the risk of consumers not using this for retirement planning. However, we consider this the most pragmatic approach unless there are changes to the tax regime which remove the tax consequences of paying redress into the consumer's DC arrangement.

Consideration of the tax implications of the payment of redress (either into a personal pension or as a cash lump sum) are excluded from the scope of this Report. However, the FCA may wish to obtain specialist tax advice in respect of this for inclusion as part of the consultation.

Considerations of approach

Consumers retain the flexibility and choice they have in their DC scheme and it enables them to use the redress in a way which is most suitable to them. It is acknowledged that retaining this flexibility is a potential advantage for some consumers if they do decide not to purchase an annuity. However, they will be taking on the investment and longevity risk (in exchange for retaining the flexibility).

This approach relies on a number of assumptions to calculate an appropriate redress lump sum. There can be difficulty obtaining consistency in these assumptions across all schemes and firms calculating redress. Inevitably there will be some cross subsidy between consumers where assumptions are generic and less tailored to individual consumers' circumstances.

The calculation can only be 'correct' at one point in time (the effective Date of Calculation) and relies on the underlying assumptions being borne out in practice. The consumer will still be subject to investment risk and ultimately changes in market conditions and consumer actions may result in the lump sum over or under compensating the consumer.

Possible approaches to calculate redress

Overall conclusions

A further limitation of Approach 4 is that the calculation will be based on the DB scheme benefits and the existing DC funds, therefore it is necessary to obtain information/data on these. The calculation will only be as good as the quality of the information obtained. In circumstances where it is not possible to obtain certain details, assumptions will be required and this opens up the possibility of inconsistent approaches being adopted across calculators of redress.

Despite the acknowledged limitations, this approach is a feasible and practical option, it provides a one-off settlement of the complaint and it provides the most equitable solution across Redress Providers and consumers.

We propose that Approach 4 (Lump sum redress representing the difference between original DB scheme & new DC scheme benefits) continues to be adopted as the approach used to calculate redress.

The calculation of the lump sum redress could be undertaken using several approaches. Within the rest of this Report we analyse theses methodologies in detail.

In line with the existing method we consider the most viable way to calculate a lump sum redress amount in practice involves valuing the original DB benefits of the consumer using a set of prescribed assumptions, with the redress amount being the difference between this amount and the value of the consumer's DC benefits. This is consistent with the existing method and meets the basic objective of redress, whilst also maintaining simplicity and transparency in approach, balancing the FCA objectives.

4. Overall redress methodology

Overall redress methodology

Meeting the basic objective of redress

Background

As set out in the previous section, we propose that a lump sum payment representing the difference between the value of the original DB scheme and the new DC scheme benefits continues to be adopted as the approach used to calculate redress.

The calculation of this lump sum will require a series of assumptions and a prescribed methodology which values the DB benefits and compares this to the value of the consumer's DC fund.

Achieving the overall aim of redress

The overall aim of redress is to put the consumer, so far as possible, into the position they would have been in if they had received compliant advice to remain in the DB scheme. This is the key principle which should underlie the methodology and assumptions in the lump sum calculation.

There are broadly two approaches to achieving this:

1. The consumer invests the lump sum and uses it to purchase an annuity from the market at the consumer's retirement to replicate the DB scheme benefits.
2. The consumer invests the lump sum and uses it to replicate the DB scheme benefits post-retirement using a drawdown approach.

The consumer will have flexibility and choice over how they use the lump sum and may choose not to fund the 'lost' retirement benefits, however the redress amount provided should be sufficient to enable them to do so.

Considerations

The second approach of seeking to replicate the DB scheme benefits using a drawdown approach would expose the consumer to a number of risks post-retirement. This includes the investment risk from the assets in which the drawdown funds were invested, plus the longevity risk of living longer than expected.

The consumer would also need to manage this drawdown fund and may require professional help which would incur charges. In this scenario the consumer is effectively having to self-insure the annuity value.

The consumer would not have been exposed to these risks in the DB scheme, nor have to undertake any post-retirement management of their benefits. Where consumers choose not to purchase an annuity, whilst they will benefit from the additional flexibility this provides, they will be exposed to additional risk.

We consider that a lump sum calculated assuming the consumer purchases an annuity at retirement to replicate the benefits they have lost from the DB scheme (i.e. the first approach outlined on the left) is in line with the FCA's objectives. This is in line with the current FG 17/9 Guidance approach.

Challenges to this approach will include that the Redress Provider is having to fund the expenses and profit margins of an insurer. Whilst this is the case, annuity purchase is the approach which does not expose the consumer to additional post retirement risk.

Overall redress methodology

Calculating the cost of an annuity

Background

The ultimate cost of purchasing an annuity at a consumer's retirement can only be truly known when quotes are obtained from the market for the individual consumer.

For Prospective Loss cases this may be a number of years in the future and therefore obtaining annuity quotes at the calculation date would not necessarily be appropriate. Considerations in respect of annuity purchase for Actual Loss cases are set out in Section 6 (Actual Loss) of this Report.

The methodologies and assumptions (set out in the rest of this Report) are therefore set to estimate the cost of purchasing an annuity at retirement. These assumptions will be based on a combination of:

- general assumptions considered appropriate for the whole population; and
- consumer specific assumptions reflecting their individual circumstances.

Where appropriate, we comment in the relevant sections of this Report on the use of consumer specific assumptions and the data collection requirements to enable this.

Possible comparators

In determining a basis for the value of an annuity, we have given consideration to the approach/assumptions in the Financial Reporting Council's ("FRC's") TM1: Statutory Money Purchase Illustrations ("SMPI") guidance and the FCA's Transfer Value Comparator ("TVC") rules, as these are also trying to calculate a notional annuity valuation.

These are both written for a different purpose than this review and therefore we may expect to see differences in approach, even if the overall principles are consistent.

We also note that the FRC are consulting on updating the SMPI guidance[1]. The consultation was issued in February 2022 and responses were required by 6 May 2022. We have considered the contents of the FRC's consultation where relevant.

[1] https://www.frc.org.uk/getattachment/785aa14d-1df6-41b8-86ae-308e566a58f7/FRC-AS-TM1-Consultation-Paper-2022.pdf

5. Assumptions and Methodology analysis

Assumptions Analysis

Our Approach

This section of the Report set outs analysis of each of the key assumptions used in a redress calculation and consideration of aspects of the calculation methodology.

We include the following elements in our analysis:

- Overview of the current approach
- Key issues for consideration
- Our considerations and proposals
- Illustrative impact of proposed changes on example consumers
- Comments on a future review framework

Within the analysis we have included indicative redress calculations for a small number of example consumers to show the impact of the proposed changes. The example consumers used are set out in Section 9 (Example consumers) of this Report.

Our analysis covers the following:

- 5a: Assumptions: Pre-retirement Discount Rate
- 5b. Assumptions: Post-retirement Discount Rate including Pension Commencement Lump Sums (PCLS)
- 5c. Assumptions: Inflation & Inflation Linked
- 5d. Assumptions: Demographic
- 5e. Methodology: Charges
- 5f. Methodology: Calculation Date & Frequency of Updates
- 5g. Assumptions & Methodology: Other
- 5h. Methodology: GMP Equalisation

5a: Assumptions: Pre-retirement Discount Rate

Assumptions – Pre-retirement Discount Rate

Current Approach

The pre-retirement discount rate is used to calculate the present value, as at the effective date of the redress calculation, of the benefits that would have been payable by the consumer's DB scheme. In the current FG 17/9 Guidance, it is set to represent the expected rate of growth of the investments within a consumer's personal pension, between the Date of Calculation and their assumed retirement date.

Under the current FG 17/9 Guidance, the pre-retirement discount rate is derived as follows.

The pre-retirement discount rate is derived as **one half of the expected return on equities**. The expected return on equity for the period to retirement is:

(1 + RPI spot inflation rate) x (1+ dividend yield) x (1 + growth in dividends) -1

Prospective long-term real dividend growth is assumed to be 0.5% per year, with dividend yields being taken from the FTSE All Share Index on the last business day of the quarter. The period to retirement is the number of integer years remaining to assumed retirement age.

In this section we review the approach adopted in the determination of the pre-retirement discount rate assumption focussing specifically on the following:

- The investment strategy assumed for the personal pension fund;
- The overall approach for determining the expected returns on equities; and
- The underlying factors used in the calculation of the equity return assumption.

The current assumption is based on the recommendations in the PwC Report as part of the 2017 Consultation and was intended to reflect the return achieved from a typical investment strategy for a consumer with savings in a DC scheme. The pre-retirement discount rate is term dependent.

The expected return is designed to represent a lower than average risk profile but not completely risk free. This was to provide a balance between:

- a low risk strategy (reflecting the consumer being exposed to the DC investment risk relative to the 'promised' benefits in the DB scheme plus the protection provided by the PPF to DB scheme members); and
- the likely return seeking approaches actually taken by the consumer in a DC scheme (and the risk of over compensating consumers).

Using an approach of 50% of the expected return on equities is aiming to target a return which does not over nor under-compensate consumers, whilst balancing the risks discussed above.

Assumptions – Pre-retirement Discount Rate

Key considerations

We consider the following issues to be key to consider in respect of the pre-retirement discount rate assumption:

- Should the pre-retirement discount rate be based on the expected return of a DC fund, or would the expected return on DB investment strategies be more appropriate (such as the pre-retirement discount rates used by DB schemes for funding purposes)?
- What is an 'average investor' and what constitutes an 'average' DC investment fund in this scenario?
- Should any adjustments be made to this 'average' portfolio to reflect the impacted population, or to reflect the individual circumstances of the consumer? For example, each individual consumer's attitude to risk or the current investments in their DC funds.
- What is the expected level of investment returns on any assumed portfolio?
- How should the return on equities be calculated? Should an allowance be made for global equity returns?
- How should the approach take into account the current market volatility?
- Should allowance be made for averaging equity returns to smooth out (short term) volatility, both currently being experienced and potential future volatility?
- Should an allowance be made for 'Lifestyling' where consumers are assumed to reduce the level of risk in their portfolio as they approach retirement?

Key objectives for this assumption include:

- To recognise that consumers who have been misadvised to transfer out of their DB scheme are likely to have a relatively cautious attitude to investment risk, but, nonetheless, now have the ability to make returns on their investments.
- The redress methodology should achieve an appropriate balance between the additional downside risks that consumers are now exposed to in a DC scheme with the upside risk that consumers' pension investments 'outperform' the assumptions and consumers are, therefore, overcompensated.
- To take account of factors such as recent and future changes to the pensions landscape, the availability of data, and actuarial standards and best practice to ensure the redress methodology and assumptions are as robust as possible over an extended period of time.
- To ensure clarity and minimise the scope for ambiguity in the application of the methodology and guidance, minimising the risk that the approach to calculating redress can be misinterpreted or manipulated.
- To enable those who undertake redress calculations or provide redress software to understand the rationale behind the methodology and assumptions and be able to apply it readily in practice.

We acknowledge that all expected return assumptions, regardless of methodology, have their limitations and may be subject to challenge.

Assumptions – Pre-retirement Discount Rate

Overall Approach

We consider that an assumption based on an 'average' DC investor's returns is an appropriate starting point on which to base the pre-retirement discount rate assumption. This is because currently and at retirement, the consumer will be in a DC scheme, and will be securing their pension income from this DC environment.

Alternative approaches such as reflecting a DB scheme's investment strategy are not considered appropriate as this would not reflect the current risk exposure of the consumer and will be impacted by other factors such as:

- strength of sponsor covenant, including any parental guarantee;
- short and long-term funding strategies, including any Long Term Funding Targets;
- interest rate and inflation rate hedging strategies; and
- membership profile and scheme maturity.

The pre-retirement discount rates used by DB schemes for funding valuations would be particularly impacted by these (and regulatory requirements) and thus are not considered to be appropriate to use for redress calculations.

Furthermore, we do not consider that it would be appropriate for the assumption to be based on each consumer's attitude to risk or current investments. Reasons for this include the fact that the attitude to risk could have been incorrectly advised, it could lead to inconsistent consumer outcomes and it would provide the least redress to those exposed to the highest levels of investment risk.

The potential for a 'banding' approach to risk appetites was also considered. This would involve a tiered approach to asset allocation, based on the varying risk profiles of different members/schemes.

However, not every member in any given pension scheme would have the same risk appetite, therefore placing the scheme in a specific 'band' may not accurately represent all members.

This also potentially introduces subjectivity and ambiguity if Redress Providers are asked to select the appropriate 'banding' for an individual consumer. We therefore do not consider it an appropriate approach.

Overall, we consider that the approach of the pre-retirement discount rate reflecting an 'average' or 'typical' DC investment strategy from the point of calculation to assumed retirement is appropriate. However, we consider that it would be inappropriate to place over-reliance on investment returns as it is the consumer who is exposed to the downside risk of these returns not being achieved and the consumer would not have been exposed to these risks in the DB scheme. We consider that a degree of prudence should therefore be allowed for in setting the pre-retirement discount rate assumption.

We consider the current approach, of building in prudence to the pre-retirement discount rate by setting it using a lower risk investment strategy than adopted under a typical DC arrangement, is appropriate to meet the FCA's objectives.

We note that the current approach uses an assumption only linked to equity returns rather than a wider portfolio of a mix of assets (e.g. equities and gilts). Whilst we acknowledge that a typical DC investment may include a wider variety of such assets, changing the approach and building in other asset classes with their own return assumptions builds in additional complexity without necessarily improving the robustness of the approach.

We propose retaining the current approach of representing the investment strategy in terms of a percentage of equity returns rather than a portfolio of asset classes.

As we will discuss on the follows pages, we have focused on building a pre-retirement discount rate which reflects a prudent view of the expected return of a typical DC investment strategy.

Assumptions – Pre-retirement Discount Rate

Determining an 'average' DC investment fund

Workplace and non-workplace pension arrangements

When considering the starting DC investment strategy we have considered the investments in both workplace and non-workplace DC pension schemes. We note that there are likely to be significant differences in the investment strategies between advised and non-advised consumers. Whilst the overall aims of workplace and non-workplace DC schemes will be broadly aligned, there is likely to be some differences in the underlying investments due to the third parties which have influence over the investment selections (such as the employer or the master trust trustee).

For workplace schemes, whilst there will be a number of different investment options and strategies adopted by consumers for their DC fund, we consider that an 'average' or typical investor would likely be invested in the default fund of their respective DC scheme. Indeed, the FCA's research as part of the CP21/32[1] consultation showed 92% of consumers are invested in the default arrangement.

For non-workplace pensions ("NWPs"), the market is made up of a number of different providers and different products. Recent FCA research has supported that consumers in these schemes often have little investment expertise and find it hard to engage with the range of choice and complexity of investment options. Many non-advised consumers believe they have opted for an 'average' or 'standard' investment strategy when making their choice, although their ultimate selection may not be a suitable choice for them.

The FCA recently issued a consultation on improving member outcomes in NWPs (CP21/32[1]). A key part of this consultation is the proposed introduction of a default arrangement for non-advised consumers in NWPs. It is proposed that this default arrangement would be designed by the providers and reflect the following:

- the likely characteristics and needs of consumers using the product;
- an appropriate and diversified allocation of assets, to manage risks while seeking investment growth; and
- an appropriate and competitive price for the product, which bears a reasonable relationship to the services being provided.

For advised consumers, there will likely be a wider range of investments, reflecting the individual advice they have received and the wide range of options available in products such as Self Invested Personal Pensions (SIPPs). The majority of the population we are considering (past DB transferees) are likely to be advised and have transferred to NWPs, although this will vary across the industry. Determining an appropriate typical investment strategy based on the actions of advised consumers in non-workplace pension schemes leads to several challenges, including:

- Relevant data on investment funds of non-workplace pension schemes is not freely available;
- Given the individual advice received and the wide range of investment options, it is considered unlikely that there is a typical investment strategy in this population;
- One of the elements of unsuitable advice may be concerning fund selection and therefore it is not considered appropriate for this to unduly influence redress; and
- Any data on investment breakdowns for NWPs as a whole will potentially be distorted by inappropriate choices made by ill-informed consumers (both advised and non-advised).

Therefore we do not consider it appropriate or feasible to base the analysis on any specific data from NWPs. We therefore have focussed on the data available for workplace DC pension schemes, specifically major UK DC Master Trusts, along with major GPP arrangements.

If the FCA's proposals to introduce default arrangements into NWPs go ahead, then it may be appropriate to review this position once that data is available, albeit we note the proposed guidance on setting these defaults is broadly aligned with that used for workplace schemes and therefore we may expect similar outcomes.

[1]www.fca.org.uk/publications/consultation-papers/cp21-32-improving-outcomes-non-workplace-pensions

Assumptions – Pre-retirement Discount Rate

Determining an 'average' DC investment fund

Lifestyling

We understand from the FCA that the average age of transferees will be greater than the average age of the typical membership of workplace pension schemes. As investment strategies tend to vary by age this may imply that the workplace pension scheme data (Master Trust and GPP) that we consider in the following pages should be adjusted to be applicable to the redress population.

A key reason for the variation in investment strategies is the practice of lifestyling where we see a change in investment strategy (to reduce risk) as a consumer approaches retirement.

Furthermore, the redress calculation is aiming to provide the consumer with the ability to purchase an annuity matching (as closely as possible) the benefits in the DB scheme. Therefore it may be appropriate to reflect consumers adopting an investment strategy targeting annuity purchase, which in essence would be a lifestyling approach.

However, there is no single 'default' lifestyling approach and so an element of subjectivity would need to be introduced to structure an approach which was appropriate. The aim would be to reduce the expected return (and thus pre-retirement discount rate) as the consumer moves closer to retirement.

This would require a term-to-retirement dependent discount rate and consider the blend of assets (or equivalently, the level of investment return) which was used to achieve the lifestyling. This would introduce a level of complexity into the redress calculations and into the disclosures to consumers to help them understand the assumption being applied.

Introducing this level of complexity into the redress methodology needs to be balanced against the wider objectives set out at the start of this section.

Due to consumers increasingly taking advantage of pension freedoms[1], typical consumers are less likely to be following a traditional lifestyling approach and so in reality we may not see as much of a reduction in the level of risk of a portfolio when approaching retirement which we traditionally may have expected. The FCA has published data (in December 2021) on "Retirement income market data"[1] which provides details of how pension plans are accessed for the first time by consumers over the period to March 2021.

Whilst the redress calculation is aiming to provide the consumer with the ability to purchase an annuity matching (as closely as possible) the benefits in the DB scheme, making full allowance for a traditional lifestyling approach is likely to overstate the level of risk reduction which consumers take and thus overcompensate consumers. Making no explicit allowance for lifestyling is still aligned with assuming a consumer targets annuity purchase provided that the level of risk assumed in the pre-retirement discount rate is appropriate.

The redress methodology should achieve an appropriate balance between the additional downside risks that consumers are now exposed to in a DC scheme with the upside risk that consumers' pension investments outperform the assumptions and consumers are therefore overcompensated.

Overall, given the additional complexity it would introduce without necessarily increasing the accuracy or robustness of the calculation, we do not consider that incorporating lifestyling into the methodology is in line with the FCA's objectives.

[1]www.fca.org.uk/data/retirement-income-market-data-2020-21

Assumptions – Pre-retirement Discount Rate

Determining an ‘average’ DC investment fund

ESG

There is an increased focus on Environmental, Social and Governance (ESG) considerations in respect of investment funds (and in particular default funds) for workplace pension schemes.

No direct allowance for ESG considerations has been made in the proposed approach to setting the pre-retirement discount rate assumption for the redress methodology. However, we would not expect more ESG focussed default funds to have materially different risk/ return profiles to current default funds.

We also note that ESG funds may have higher charges than non ESG funds. However, as set out in Section 5e (Charges) of this Report, it is proposed that an uncapped allowance for actual personal pension charges is allowed for. Therefore if consumers are within ESG funds (which have higher charges) then this would not directly impact the appropriateness of the proposed approach.

Disclosure to consumers

As already noted, there are going to be a wide range of investments which consumers are actually invested in and these will, in some cases, differ to that being assumed for the pre-retirement discount rate assumption used in redress calculations.

Alongside a number of other key assumptions set out in this Report, we consider it is important to communicate to the consumer what is being assumed. This will support the objective of helping consumers understand how their redress has been calculated. We consider that Redress Providers should make it clear what investment strategy is being assumed in the pre-retirement discount rate and that if they are investing differently (including any use of lifestyling) the ultimate impact on their benefits may vary.

Assumptions – Pre-retirement Discount Rate

Determining an ‘average’ DC investment fund

Analysing ‘average’ market investment strategies

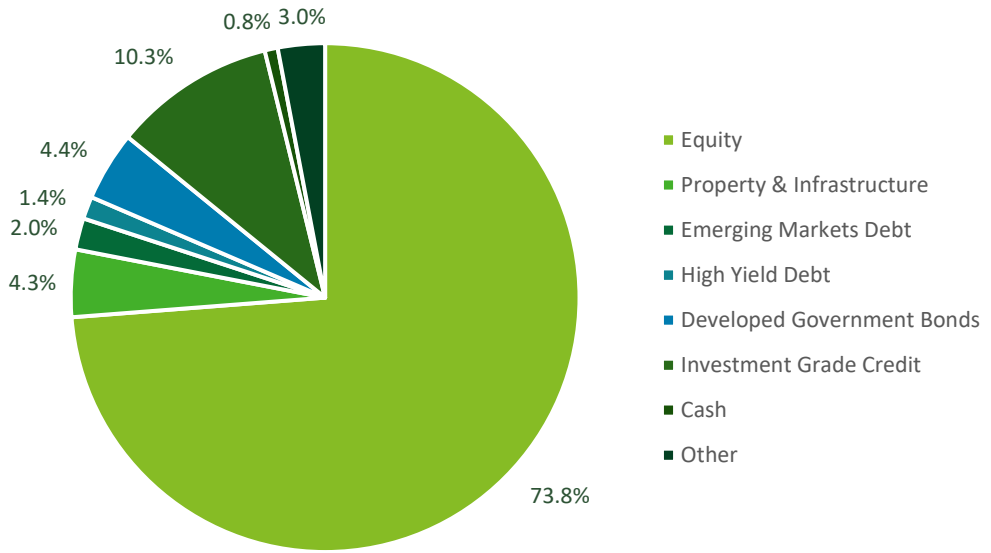
The chart on the right shows our analysis of the average default strategy for several of the major UK DC Master Trusts, along with major GPP arrangements. Details of the funds are set out in Appendix 1. Where different default options are available this analysis includes the one representing a ‘growth’ phase.

We have considered the expected return assumptions for the underlying asset classes and converted these to an equivalent equity return assumption. This analysis shows the average investment strategy is equivalent to 86% of our current house-view equity return assumption (the “Average Investment Strategy” or “Average Equity Percentage”). This means that whilst the portfolio may only be 73.8% equities, the rest of the assets contribute a level of return which mean it is overall expected to provide a return equal to that of 86% of the return on equities. This can be compared against the 50% of the return on equities which is used for the pre-retirement discount rate in the current FG 17/9 Guidance.

We have also considered the make-up of the FTSE Private Investor Index Series, which has been widely used in the Pensions Industry as being representative of a typical asset portfolio for consumers with different attitudes to risk (this is also consistent with our understanding of the indices adopted in a number of FOS rulings relating to investment returns[1]).

This index suggests a ‘Balanced’ investor’s portfolio is made up of c.60% equities, with the next level ‘Growth’ investor having c.70% invested in equities, with the remainder invested in a mix of corporate and government bonds and other investments. Using the same approach as above, these are broadly consistent with a portfolio providing a return in line with c70% and c80% of the return on equities assumption respectively.

Investment Strategy - Average DC arrangement



Source: Deloitte analysis of the average default strategy for several of the major UK DC Master Trusts, along with major GPP arrangements (see Appendix 1).

[1] Example FOS ruling: www.financial-ombudsman.org.uk/decision/DRN-3102120.pdf

Assumptions – Pre-retirement Discount Rate

Determining an 'average' DC investment fund

Analysing 'average' market investment strategies

We consider it appropriate that an adjustment is made to the returns of the 'average' portfolio in order to reflect the additional risk that consumers are now exposed to in a DC environment, in comparison to the DB environment they would have been in had they not transferred.

In order to determine a lower risk investment strategy or "Lower Risk Equity Percentage", using stochastic modelling, we have estimated the probability that the return of the Average Investment Strategy will match or exceed the median return under a series of lower risk strategies, expressed in terms of the percentage of equity.

This is representing the probability (recognising the limitations of all such asset modelling techniques) that the consumer's actual fund (represented by the Average Investment Strategy) will outperform the portfolio that we are assuming (i.e. the consumer is better off). This is illustrated in the table below.

This shows that adopting a portfolio consistent with a 50% return on equities has a c.9% margin for prudence (59% shown in the table noting this will be sensitive to exact modelling assumptions) over the 'Average Investment Strategy'.

We consider that this level of prudence is reasonable in the context of the FCA's objectives and therefore propose the existing approach of adopting a pre-retirement discount rate assumption consistent with a 50% return on equity is retained.

The level of prudence that should be included is a subjective assessment and the FCA may have a different view on the appropriate level of prudence to be adopted.

	Equivalent Equity Return Percentage	Probability of the 'Average Investment Strategy' at least matching the median return of the 'Lower Risk' strategy
Average Investment Strategy	86%	50%
FTSE Private Investor Balanced Index	70%	52%
	60%	55%
Current pre-retirement discount rate	50%	59%
	40%	67%
	30%	70%

Represents a 9% 'margin for prudence'

Assumptions – Pre-retirement Discount Rate

How should equity returns be calculated

The current formula for determining an equity return assumption (as set out in the box below) represents a traditional 'build-up' approach and is commonly used across market participants. It assumes that equity returns equal current dividend yields plus future growth in dividends. The methodology assumes that dividends grow in line with nominal GDP growth.

The current FG 17/9 Guidance states that the pre-retirement discount rate should be derived as one half of the expected return on equities. The expected return on equity used for the period to retirement is currently calculated using the following formula:

(1 + **RPI spot inflation rate**) x (1+ **dividend yield**) x (1 + **growth in dividends**) - 1

Prospective long-term real dividend growth is assumed to be 0.5% per year, with dividend yields being taken from the FTSE All Share Index on the last business day of the quarter. The period to retirement is the number of integer years remaining to assumed retirement age.

Like other methodologies, the approach has its limitations including an assumption that historical dividends will be sustainable into the future. The methodology also has the potential to generate return assumptions which may prove to be relatively volatile over the short term. However, the approach is straightforward, commonplace and predominantly relies on market observable data.

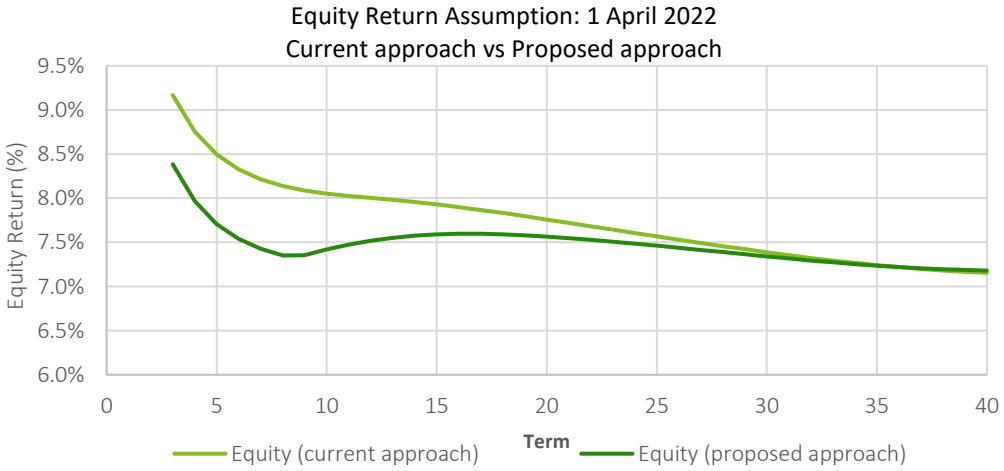
Consequently, we propose retaining the current overall methodology for determining the equity return assumption. We do however propose a detailed review of the inputs into the calculation.

The calculation is made up of three elements and we have proposed changes to each of these elements separately over the next few pages:

1. Dividend Yield
2. Growth in Dividends
3. RPI spot inflation rate

Our proposed amendments to these elements are not structured to specifically increase or decrease the discount rate, rather to improve the robustness of the approach and to make the equity return assumption more stable over time.

Details of the individual changes are covered on the following pages, however to provide context, the graph below gives an illustration of the overall impact on the expected return on equity assumption as at 1 April 2022 of our proposed changes. At this date, our proposed revised methodology results in lower or broadly equal equity return assumptions for maturities of up to 40 years as shown below. Note the change in shape (on the proposed approach) around 8 years is a function of the interaction of the shape of the RPI yield curve and the deduction applied to derive a CPI assumption.



Assumptions – Pre-retirement Discount Rate

Equity returns – Dividend Yield

The current approach references the **dividend yield** on the FTSE All Share Index. Using a global index would be preferable given that we expect that most DC arrangements will have an allocation to overseas equities.

However, we recognise that obtaining dividend yields on overseas market indices such as the FTSE All World Index would be a change in methodology. Furthermore there would need to be more onerous changes to the Inflation and Growth in Dividend assumptions to make them consistent with a global index. We do not consider that these changes in methodology are sufficiently merited and hence we consider it reasonable to continue to reference the FTSE All Share Index.

We do however propose that the FCA moves away from using the dividend yield at a single timepoint (the last quarter end), given that it is highly dependent on market conditions at that point in time and the dividends paid by index constituents over a single 12 month period. These features make the dividend yield assumption more volatile in our view and increases the risk that the dividend yield assumption proves to be less representative of future conditions.

Two alternative approaches could be adopted:

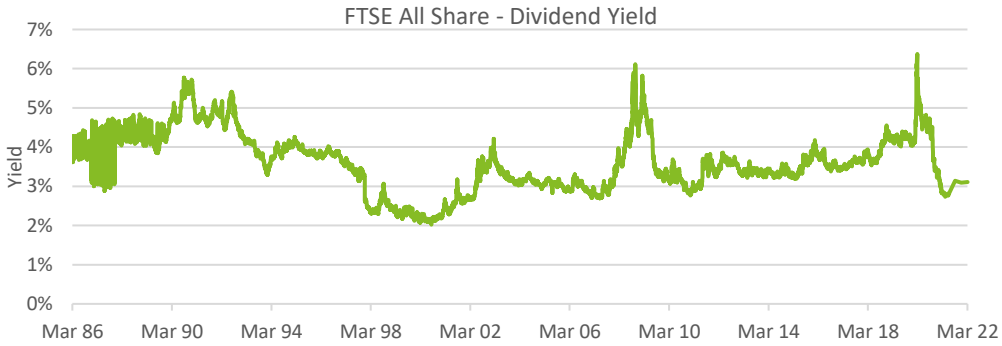
a) The use of a long term historical average dividend; or

b) A form of rolling average dividend yield assumption.

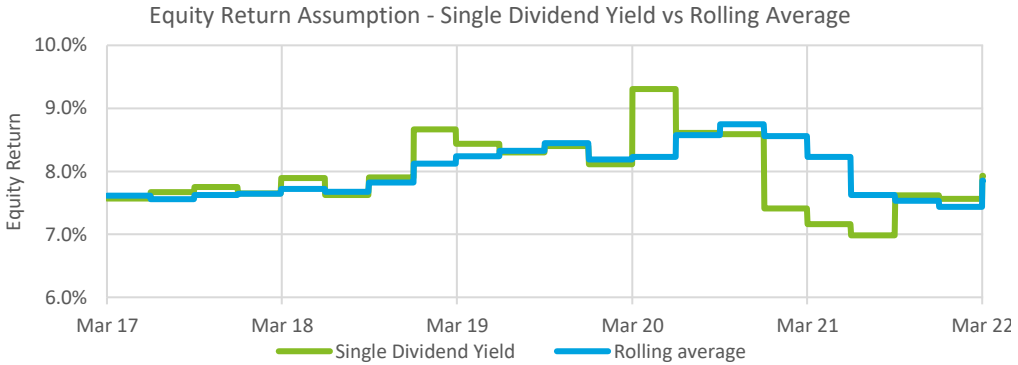
Of these options our preference is for b) given that option a) will include historical data that is unlikely to prove representative of current economic conditions. Option b) provides a more sustainable dividend yield in our view and will reduce the volatility in both the dividend yield and resulting equity return assumption.

We propose that the redress methodology is updated from using the dividend yield at the previous quarter end, replacing it with a rolling average of the dividend yield at the previous four quarter ends.

We have included comments in Section 5f (Methodology: Calculation Dates & Frequency of Updates) of this Report on the frequency of updating market conditions. The specifics of the rolling average should be consistent with the update frequency. For example if monthly updates were adopted, then it may be appropriate to have a rolling average over each of the previous 12 months. In general, the more frequent the updates, the smoother the dividend yield assumption would be.



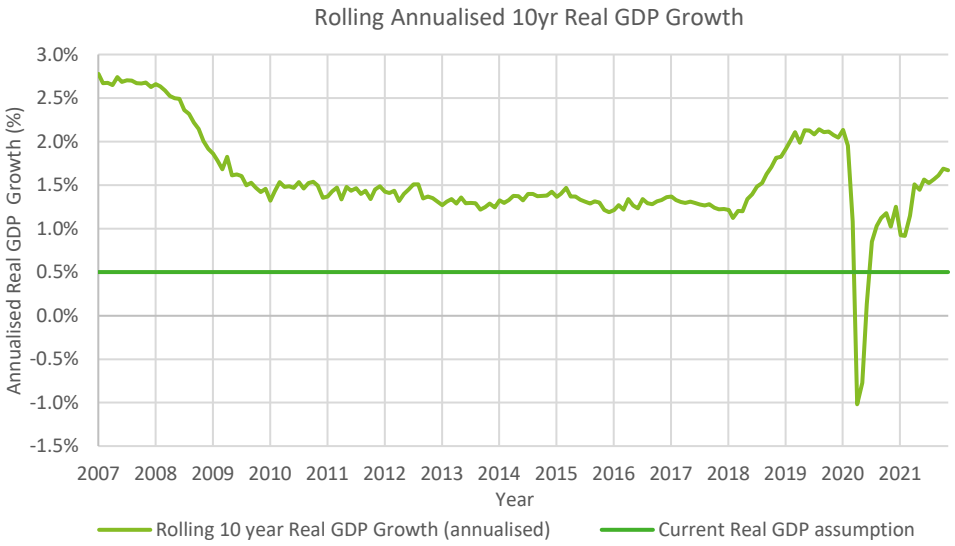
The chart below shows the derived equity return assumption over the last 5 years under the current and proposed approaches for setting the dividend yield assumption (but keeping the other elements the same as the current FG 17/9 Guidance) assuming a constant 15 year term to retirement and a dividend growth rate of 0.5%.



Assumptions – Pre-retirement Discount Rate

Equity returns – Growth in Dividends

The **Growth in Dividends** is ultimately a real GDP growth assumption. The current methodology assumes a constant rate of 0.5% p.a. We are of the view that 0.5% underestimates historical real GDP growth.



Source: ONS Monthly GDP estimate)

GDP has proved to be reasonably volatile, with the Global Financial Crisis and COVID-19 pandemic causing significant movements in calendar year GDP. However, the equity return assumption should be medium to long term in nature and hence we have considered annualised real GDP growth over rolling 10 year periods in the chart above. This analysis suggests that a real GDP growth assumption of 0.5% p.a. underestimates average real GDP growth historically. We believe that a real GDP growth assumption of between 1.0% to 1.5% per annum would be more representative.

That said, there is no guarantee that GDP growth will, on average, trend at or around an historic average level. We therefore suggest that some consideration is given to the use of forward-looking growth expectations. A number of market participants will aim to forecast future economic growth to varying levels of sophistication but these expectations are typically short term in nature. The UK's Office of Budget Responsibility provides regular economic forecasts which extend for c.5 years. The recent expectations are shown in the table below.

	2022	2023	2024	2025	2026
UK GDP	3.8%	1.8%	2.1%	1.8%	1.7%

Source: Office for Budget Responsibility – Economic & Fiscal Outlook – March 2022

It may be possible to adopt an approach whereby the real GDP growth assumption is an average of these OBR forecasts for the first 5 years and a fixed real GDP growth assumption of say 1% over the remainder of the period to assumed retirement. Whilst this is our preference from a theoretical perspective, it would be more straightforward to retain a constant GDP growth assumption, albeit set to a higher level.

In summary, we consider that a constant real GDP growth assumption continues to meet the FCA's objectives, however that the assumption is increased to 1.0% p.a. This represents the lower end of what we would consider as the typical range of historical average of real GDP growth.

Assumptions – Pre-retirement Discount Rate

Equity returns – RPI Inflation

The current approach for the **RPI spot inflation rate** references the Bank of England gilt implied inflation curve. The assumption is term dependent requiring the user to match maturity with a consumer's remaining term to assumed retirement. We are supportive of the use of gilt implied inflation given that it is readily available and enables a term dependent inflation assumption. We do however propose a change to the existing methodology.

Gilt implied inflation provides an estimate of future RPI inflation. History has shown that the Bank of England inflation curve is not a reliable predictor of actual RPI and can be particularly susceptible to demand and supply imbalances. We believe that there is excess demand for index-linked gilts by UK pension schemes and other investors seeking inflation protection. This results in an inflation risk premium (or "IRP"). The IRP is notoriously difficult to quantify but market participants typically use an IRP ranging from 0% to 0.3% p.a.

We have set out further commentary on IRPs in Section 5c (Assumptions: Inflation & Inflation Linked) of this Report. Despite the challenges in determining an appropriate IRP, we believe that it is right to make an allowance for its existence and we have proposed that an IRP of 0.2% is used for inflation linked revaluation pre-retirement.

We propose that the same 0.2% adjustment for an IRP is applied in the calculation of the expected return on equities used in the pre-retirement discount rate. Where the benefits are inflation linked pre-retirement, the application of the IRP in both elements will partially offset.

As discussed, gilt implied inflation represents future expectations of RPI. Under the existing methodology, the inflation assumption is used to effectively convert real GDP growth into nominal GDP growth or dividend growth. However, real GDP is quoted relative to CPI rather than RPI.

We therefore propose that the inflation assumption used in the derivation of the return on equities should reflect expectations of CPI rather than RPI inflation.

Details on the proposed approach for setting the CPI inflation assumption are contained in Section 5c (Assumptions: Inflation & Inflation Linked) of this Report. In summary we propose a formula based approach which reflects the alignment of RPI with CPIH post 2030.

As set out in the Inflation section of this Report, in the interests of practicality, making the formula easier to understand and reducing the risk of incorrect application it may be appropriate to accept a loss of accuracy in the calculation of CPI, for example by forgoing the potential use of forward rates or geometric averaging.

The difference on redress of adopting a simple approach is likely to be small once the assumption has been rounded. Furthermore as we are proposing the same approach for both the discounting and increase assumptions, the overall impact of this reduction in accuracy will be partially offset.

Assumptions – Pre-retirement Discount Rate

Overall Conclusions

Overall, our proposed methodology remains term dependent, is composed of easily accessible metrics and is fundamentally similar to the current approach. However, based on the FCA's objectives, we consider that a series of adjustments are warranted when it comes to determining the underlying inputs to the calculation, either on theoretical grounds or to improve assumption stability.

Current Approach

The pre-retirement discount rate is derived as one half of the expected return on equities. The expected return on equity for the period to retirement is:

(1 + RPI spot inflation rate) x (1+ dividend yield) x (1 + growth in dividends) - 1

Prospective long-term real dividend growth is assumed to be 0.5% per year, with dividend yields being taken from the FTSE All Share Index on the last business day of the quarter. The period to retirement is the number of integer years remaining to assumed retirement age.

The final assumptions should then be rounded to the nearest 0.05%

Proposed Approach

The pre-retirement discount rate is derived as one half of the expected return on equities. The expected return on equity for the period to retirement is:

(1 + CPI spot inflation rate) x (1+ average dividend yield) x (1 + growth in dividends) - 1

The period to retirement should be taken as the number of integer years remaining to assumed retirement age.

Where:

CPI spot inflation is derived in line with the (unrounded) approach set out in Section 5c (Assumptions: Inflation & Inflation Linked) of this Report.

Average dividend yield = The arithmetic average of the dividend yield on the FTSE All Share Index of the last business day over the last four quarter ends.

Growth in dividends = Fixed 1% p.a.

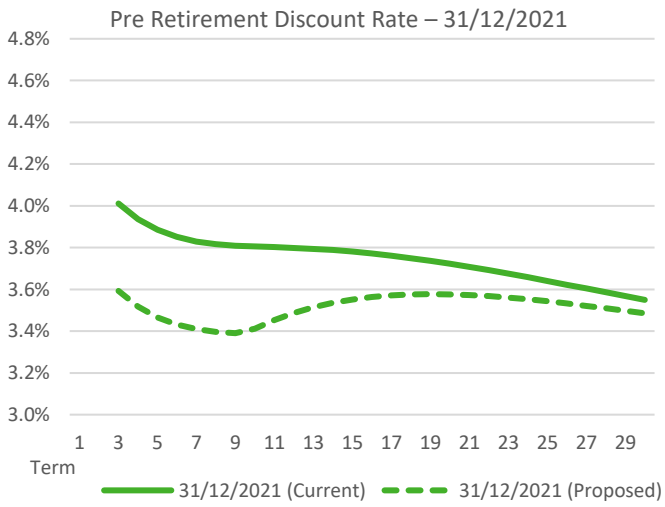
The final assumptions should then be rounded to the nearest 0.05%

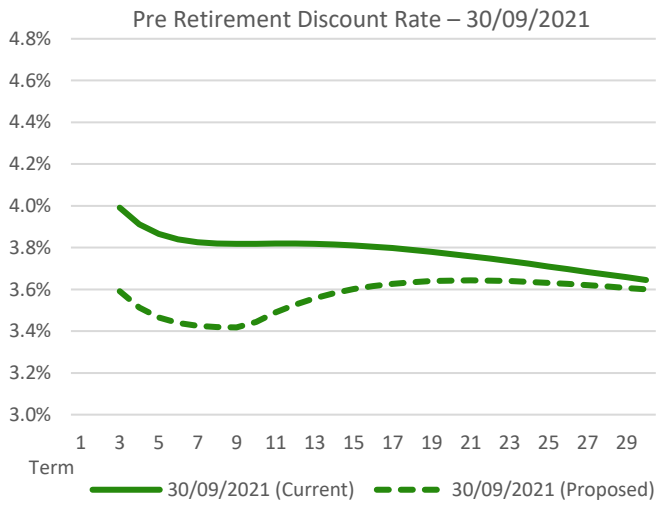
Assumptions – Pre-retirement Discount Rate

Impact - assumptions

The tables and graphs below show the impact on pre-retirement discount rate assumptions of the proposed changes. The changes are greater at the shorter terms and narrow as the term increases. Whilst the three most recent quarters (as shown below) show a decrease in discount rate under the proposed approach, there will be periods where the reverse is the case, with the proposed approach giving a higher discount rate (and lower redress amount). Indeed this would have been the case as at 30/6/2021 when the impact of the COVID-19 pandemic was still being prominently seen in the historic dividend yield figures. This is shown in Appendix 2.

Date	Term to retirement											
	5 years		10 years		15 years		20 years		25 years		30 years	
	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach
31/03/2022	4.25%	3.85%	4.05%	3.70%	3.95%	3.80%	3.90%	3.80%	3.90%	3.70%	3.70%	3.65%
31/12/2021	3.90%	3.45%	3.80%	3.40%	3.80%	3.55%	3.70%	3.55%	3.65%	3.55%	3.55%	3.50%
30/09/2021	3.85%	3.50%	3.80%	3.45%	3.80%	3.60%	3.75%	3.65%	3.70%	3.65%	3.65%	3.60%





Assumptions – Pre-retirement Discount Rate

Impact on value of DB benefits

The table below shows the impact on the value placed on the DB scheme benefits of the changes proposed for the pre-retirement discount rate assumption in isolation for a selection of example consumers. All other assumptions/methodologies have been maintained in line with the current FG 17/9 Guidance. Details on the example consumers we have considered are set out in Section 9 (Example consumers) of this Report, with key details in the table at the bottom of this page.

Illustrative impact of proposed changes:

Example Consumer	Value of Defined Benefits at Date of Calculation - Current Approach	Value of Defined Benefits at Date of Calculation – Proposed Approach	Change in Value increase/(decrease)	% Change in Value increase/(decrease)
1	£498,312	£516,818	£18,506	3.7%
3	£280,159	£285,575	£5,416	1.9%

All calculations are undertaken with a calculation date of 1 April 2022, i.e. using assumptions as at 31 March 2022. Calculations undertaken on a different date may result in different outcomes. The percentage impact on redress would differ depending on the value of the DC benefits.

Causes of change in value

Consumer 1: The increase in value is caused by the reduction in the pre-retirement discount rate from 4.05% to 3.70%.

Consumer 3: The increase in value is caused by the reduction in the pre-retirement discount rate from 3.90% to 3.80%.

It should be noted that as the pre-retirement discount rate is proposed to be updated to include reference to the updated CPI assumption (which includes the impact of the Inflation Risk Premium), some of the above impact will be offset when the full proposed basis is considered and the updated CPI assumption is also used in the calculation for revaluation (rather than just for the pre-retirement discount rate assumption in isolation as shown here). The overall impact on consumers as shown in Section 9 (Example Consumers) of this Report should therefore be considered in addition to the above.

Key Details of Example Consumers	Consumer 1	Consumer 3
Term to retirement	10	20
Retirement Age	65	60

Assumptions – Pre-retirement Discount Rate

Future review

Future review

If the FCA's proposals to introduce default arrangements into non-workplace pension schemes go ahead, then it may be appropriate to review the approach to setting the pre-retirement discount rate assumption once that data is available. Albeit we note the guidance on setting these defaults is broadly aligned with that used for workplace schemes and therefore we may expect similar outcomes.

If there is a material change in the composition of default funds in either workplace or non-workplace pension schemes, a review of the assumed equity content allowed for in the pre-retirement discount rate assumption would be required.

Given the importance of this assumption to the value placed on DB benefits for Prospective Loss cases, we consider that a review of this assumption should be undertaken every four years as a minimum.

5b. Assumptions: Post-retirement Discount Rate

Including Pension Commencement Lump Sums (PCLS)

Assumptions – Post-retirement discount rate

Current approach

The post-retirement discount rate assumption is used to calculate a capitalised value at the point of retirement of the future DB pension benefits that the consumer and their dependants would have received after they have retired/died.

Under the current FG 17/9 Guidance, the post-retirement discount rate is derived as follows.

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 integer period to retirement and the discounted mean term, 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 integer 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.

An adjustment is also made to the post-retirement discount rate assumption to allow for the option for the consumer to take a pension commencement lump sum.

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%.

This may be modified to reflect actual pension commencement lump sum percentages for actual loss cases or where the pension commencement lump sum was additional to pension income in the original scheme.

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

Assumed retirement age	**55**	**60**	**65**	**70**	**75**
DMT	23	20	16	13	11

Discounted mean terms for other assumed retirement ages up to 65 should be based on linear interpolation and rounded to the nearest integer.

Assumptions – Post-retirement discount rate

Key considerations

We consider the following issues to be key to consider in respect of the post-retirement discount rate assumption:

- Is setting a discount rate which aims to target annuity pricing an appropriate approach?
- Is the Bank of England nominal government bond yield curve the most appropriate yield curve to use to derive the post-retirement discount rate assumption?
- Is the approach of using Discounted Mean Terms to derive the post-retirement discount rate assumption appropriate? If so, are the current set of Discounted Mean Terms appropriate?
- What approach should be taken to allow for annuity pricing margins in deriving the post-retirement discount rate assumption?
- Is 0.6% a reasonable deduction to gilt rates to allow for the effects of annuity pricing and how should this be determined?
- Should allowance be made in the post-retirement discount rate assumption for consumers to commute pension for cash at retirement? If so, what adjustment to the post-retirement discount rate should be made?

Some elements in the derivation of the post-retirement discount rate assumption will be subjective and careful consideration will be needed to reduce the risk of either over or under compensating consumers.

These factors will need to be carefully balanced with the objective of future-proofing the approach and limiting the need for regular updates by the FCA.

The revised redress methodology will need to clearly state how assumptions should both be derived and applied in practice to remove any elements of ambiguity.

Key objectives for this set of assumptions include:

- Appropriate redress must, as far as possible, put the consumer into the position they would have been in if they had received compliant advice.
- To take account of factors such as recent and future changes to the pensions landscape, the availability of data, and actuarial standards and best practice to ensure the redress methodology and assumptions are as robust as possible over an extended period of time.
- To ensure consistency of approach between firms carrying out the calculation.
- To ensure clarity and minimise the scope for ambiguity in the application of the methodology and guidance, minimising the risk that the approach to calculating redress can be misinterpreted or manipulated.
- To enable those who undertake redress calculations or provide redress software to understand the rationale behind the methodology and assumptions and be able to apply it readily in practice.

Assumptions – Post-retirement discount rate

Choice of underlying yield curve

Under the existing FG 17/9 Guidance, the initial post-retirement discount rate is calculated with reference to the Bank of England nominal government bond (gilt) yield curve, and depends on the individual consumer's term to retirement and weighted average term over which their DB pension would have been expected to be paid (also known as the discounted mean term ("DMT")).

The existing methodology works by calculating an interest rate implied by the yield curve that will apply at the point the consumer retires (which may be in the future), over a term equal to the discounted mean term (which depends on their retirement age).

A deduction of 0.6% is then applied to this rate to allow for the margins built in to annuity pricing. The resulting interest rate is known as the initial post-retirement discount rate.

In reviewing the approach used to derive the initial post-retirement discount rate there are a number of areas to consider, namely:

- The choice of underlying yield curve;
- The appropriateness of the discounted mean terms; and
- The adjustment used to allow for annuity pricing.

The choice of underlying yield curve must be aligned with the overall approach to calculating redress as discussed in Section 4 (Overall redress methodology) of this Report.. As discussed in this section, we consider that the overall approach to calculating redress should take the form of a lump sum payment with the consumer assumed to purchase an annuity at retirement to replicate the benefits they would have received from the DB scheme.

Based on this approach, it is logical to consider the yield curves used by insurers when pricing annuity contracts. Our understanding is that a number of insurers use the Sterling Overnight Index Average ("SONIA") curves to price annuity contracts.

Whilst these curves may be more accurate than the Bank of England gilt curves in replicating the pricing methodologies of insurers, the SONIA curves are not as readily available as the Bank of England gilt curves. We would also expect the SONIA curves to be less well understood by Redress Providers, given the wide use of the Bank of England gilt curves in other areas of actuarial pensions work.

Consideration should also be given to the curves used to set the post-retirement discount rate assumptions in the FRC's TM1: Statutory Money Purchase Illustrations ("SMPI") guidance and the FCA's Transfer Value Comparator ("TVC") rules, as these are also trying to calculate a notional annuity valuation. Both of these calculate discount rates based on the 5 year yield on the FTSE Actuaries Government Securities Index-Linked Real Yields.

Whilst consistency with SMPI and TVC approaches would be desirable, the post-retirement discount rates derived using these are not term dependent and the SMPI discount rate is only updated once a year. These are both written for a different purpose than this review and therefore we may expect to see differences in approach, even if the overall principles are consistent. The SMPI and TVC approaches are not considered the most appropriate for the purpose of redress calculations as it is unlikely to accurately replicate annuity pricing for an individual consumer at the date of redress calculation.

We therefore consider it reasonable to continue deriving the initial post-retirement discount rate with reference to the Bank of England gilt curves, with the yield curves updated quarterly (further details on the frequency of updating the assumptions for changes in market conditions are set out in Section 5f (Methodology: Calculation Dates & Frequency of Updates) of this Report).

Assumptions – Post-retirement discount rate

Discounted mean term

The most accurate approach to calculating the value of future DB pension payments at the redress calculation date would be to derive individual post-retirement discount rates for each future pension payment. These individual discount rates would depend on the term until each pension payment is made, and the yield implied by the Bank of England gilt curve for each term (for example, for a pension payment made in 3 years time, you could select the 3 year spot rate from the Bank of England gilt curve to derive an individual discount rate assumption for this pension payment).

This is a complex approach however, and we would expect that implementing this approach would be difficult for providers of redress calculation software.

The current approach used to derive the post-retirement discount rate instead considers the weighted average term of the future pension payments for consumers with different retirement ages (i.e. the number of years until the average pension payment is made, weighted by the pension amounts). The average term is known as the discounted mean term ("DMT"). The table below shows the current DMTs in use.

Assumed retirement age	55	60	65	70	75
DMT	23	20	16	13	11

When compared against the FCA's objectives, we consider this approach to be a reasonable compromise between accurately allowing for the term structure of the gilt yield curve, whilst also recognising software implementation limitations.

This approach is also easier for consumers to understand, as it means that one post-retirement discount rate assumption is derived, rather than a series of assumptions for each individual pension payment.

As we propose maintaining the overall approach of using DMTs, we have then considered whether the existing DMTs remain appropriate given changes in market conditions since the 2017 Consultation, and the proposed updates to the assumption methodology set out in this paper.

The DMT shows the weighted average term of the future pension payments due to the consumer which is sensitive to changes in interest and inflation rates, and most importantly to the difference between these two rates (known as the "net rate").

We have identified the maximum and minimum net rates that were present over the last five years to 31 March 2022. We have then used these net rates to calculate each of the DMTs, to give an indication of the sensitivity of the DMTs to changes in market conditions. These are shown in the table below (rounded to the nearest whole year).

Assumed retirement age	55	60	65	70	75
DMT - maximum net rate (-1.45%)	21	18	15	12	10
DMT - minimum net rate (-2.90%)	23	20	16	13	11

As can be seen, the existing DMTs are in line with those calculated using the minimum net rate (and broadly in line with those calculated using the maximum net rate).

We therefore do not consider that there is sufficient justification to move away from the current set of DMTs, when considered against the FCA's objectives.

Assumptions – Post-retirement discount rate

Adjustment to allow for annuity pricing

When pricing annuity contracts, insurers typically include a margin to cover the expenses of writing the contract and to allow for profit on the contract. The existing FG 17/9 Guidance makes allowance for this by deducing 0.6% p.a. from the interest rate derived from the Bank of England gilt curve. In line with the existing approach, we propose that an adjustment is made to the rate produced from the Bank of England gilt curve to reflect actual annuity rates in the open market.

The choice of the adjustment is subjective, as each insurer will use a different approach to price annuity contracts. Further, different adjustments will be made for different shapes of annuities (i.e. for different increases, spouse benefits etc), based on market supply/demand and the insurer's risk profile. Insurers pricing approaches can change regularly and thus it is difficult to exactly replicate insurer pricing.

Nevertheless, to assess whether the deduction of 0.6% p.a. remains appropriate it is necessary to consider annuity quotations available in the market, and compare these to annuity factors calculated using the assumptions methodology proposed in this Report to understand the quantum of the deduction to the initial post-retirement discount rate implied by the open market annuity quotations.

The Government's Money Helper service (previously the Money Advice Service and the Pensions Advice Service) allows individuals to obtain annuity quotations. We maintain a database of the historic best annuity quotations available on the first working day of each month for a notional male aged 65 from this service.

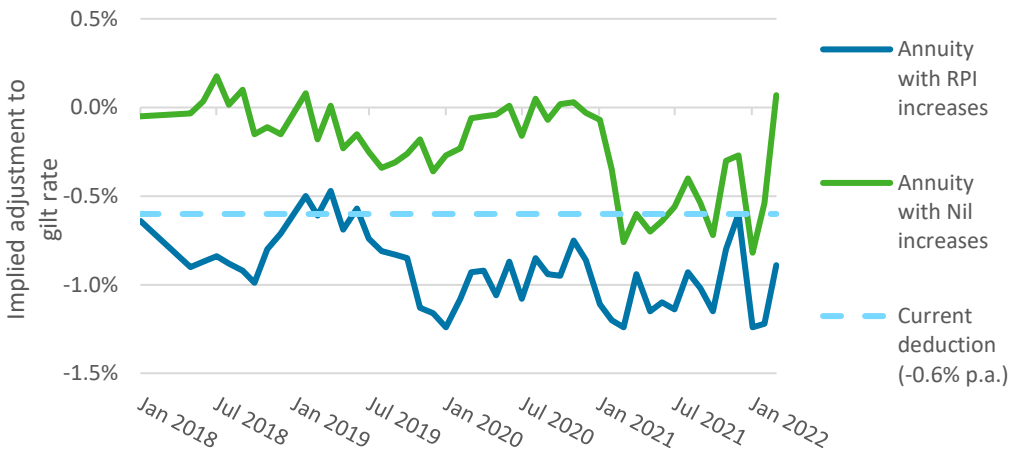
We have calculated annuities at each historic date (using assumptions derived in line with the proposed assumption methodologies set out in this Report), and have aimed to replicate the Money Helper annuity quotation by making an adjustment to the initial post-retirement discount rate. The chart on the next page tracks the implied adjustment for an annuity with no pension increases and for an annuity with RPI linked pension increases. The chart also shows the current 0.6% p.a. deduction for comparison.

Whilst this analysis is useful, we note that there are some limitations in this analysis. The quotations available on the Money Helper website are only indicative, as actual annuity pricing will take into account the specific circumstances of each consumer (i.e. post code, health details). We have used proxy values for the purposes of this analysis.

Assumptions – Post-retirement discount rate

Adjustment to allow for annuity pricing

Adjustment to initial post-retirement discount rate implied by annuity quotations (for a notional male aged 65, as provided by Money Helper)



This chart shows that the implied adjustment varies considerably over time. The implied adjustment also varies based on the pension increase applied (i.e. a larger deduction is implied for inflation linked pension increases due to the additional risk of unknown future inflation).

It could be argued that separate deductions should be applied to the post-retirement discount rate depending on the nature of the pension increases, in particular one deduction could be set for nil/fixed increases and a separate deduction for inflation linked increases. The existing approach effectively assumes an average across all increases and therefore will over-value some pensions and under-value others. The exact impact on individual consumers will depend on the pension increases provided on their DB benefits.

Whilst separate deductions would theoretically provide more accuracy, this would be complex and may be difficult to implement for providers of redress calculation software. Furthermore, there is a degree of subjectivity in setting the level of deduction due to market volatility and the intention to also cover the expenses of securing the annuity.

Based on this analysis, the subjective nature of the adjustment and the desire for simplicity in how the deduction should be applied, we consider that the current 0.6% p.a. deduction to the initial post-retirement discount rate to allow for the margins built in to annuity pricing continues to meet the FCA's objectives.

Assumptions – Post-retirement discount rate

Allowance for Pension Commencement Lump Sum (PCLS)

At retirement, in DB schemes, consumers typically have the option to commute a proportion of their pension for a tax free cash lump sum, known as a Pension Commencement Lump Sum ("PCLS").

Experience shows that the majority of consumers take a PCLS from their DB schemes and the current redress methodology therefore makes an allowance for consumers to take a PCLS at retirement.

The amount of cash that a member receives will be determined by the PCLS factors in force in the DB scheme at the point the member retires. For example, a PCLS factor of 20:1 would mean a member receives £20 of cash for every £1 of pension they give up. Generally it is only the member's pension which is commuted, with any spouse's or dependant's pension not impacted.

These PCLS factors are usually set by trustees, sponsoring employers, scheme actuaries or a combination of these parties (depending on the rules of the DB scheme). Factors will vary across different schemes, reflecting the different pension benefits which are being commuted (in particular the level of increases the DB pension would have received) and the basis used to set the factor.

In our experience, the value of the PCLS factors used has little impact on the proportion of pension which is commuted by members.

Even where a DB scheme uses factors which offer poor value, members will still commonly commute the maximum or close to the maximum amount.

For Prospective Loss cases, the current redress approach makes an allowance for consumers to take a PCLS through the application of an adjustment to the initial post-retirement discount rate. An addition of 1.60% p.a. is made to 25% of the initial post-retirement discount rate, to allow for the assumption that consumers would have commuted this part of their DB pension for cash.

This is an approximate approach based on the principle that the adjusted discount rate represents the lower actuarial value of the cash being taken (as the positive adjustment to the discount rate results in a lower overall value being placed on the DB pension). This is an alternative to using PCLS factors as described opposite.

Whilst the approach does not use explicit PCLS factors, it is possible to calculate the implied PCLS factors that the existing approach is analogous to. These will vary based on the discount rate and pension increase assumptions assumed. The table below sets out the implied PCLS factors for a member aged 65 as at 1 April 2022 for the corresponding pension increases. We have shown two alternative discount rates and one alternative RPI assumption to demonstrate the volatility of these results.

	Implied PCLS Factor (for a member aged 65)		
Pension increase level and assumption	Discount rate = 1.15%	Discount rate = 1.65% (as per proposed approach at 01/04/22)	Discount rate = 2.15%
Nil – 0% p.a.	16.5	15.7	14.9
RPI max 5% - 4.10% (as at 01/04/22)	26.0	24.4	22.9
RPI max 5% - 3.05%	23.1	21.8	20.5

Note: Discount rate stated includes allowance for PCLS adjustment. E.g. 1.65% = 75% x 1.25% + 25% x (1.25% + 1.60%). RPI max 5% rate of 3.05% is included to show sensitivity of factors.

Assumptions – Post-retirement discount rate

Allowance for Pension Commencement Lump Sum (PCLS)

A useful piece of analysis would be to compare the PCLS factors implied by the current approach with those factors commonly used in the market to identify how consistent they are. This analysis however will have many limitations, not least due to the lack of published information on the PCLS factors used by DB schemes. The factors will also have been set in line with different requirements and reflecting different benefit structures.

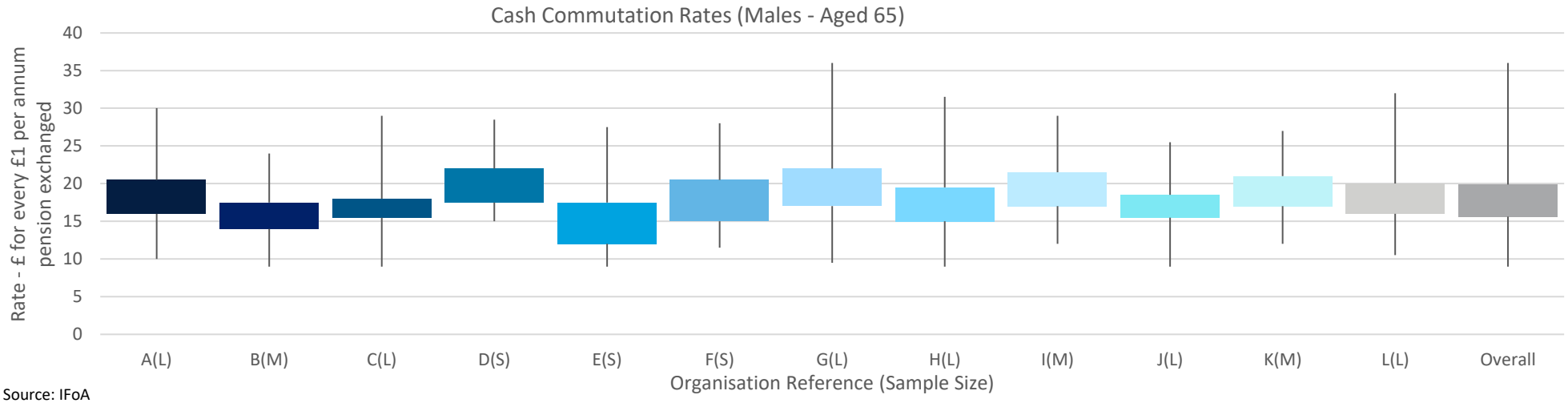
Noting these limitations, in December 2020 the IFoA published some benchmarking on PCLS factors in their "Pensions: actuarial factors used to calculate benefits in UK pension scheme – Thematic Review Report"[1] (the "Thematic Review"). This asked organisations for factors applying in March 2020.

The graph below sets out the cash commutation rates for a male at age 65 (with a pension increasing in payment with RPI up to 5% p.a.) for a selection of organisations that responded to the IFoA's survey (labelled as organisation A to L, with the sample size (either small (S), medium (M) or large (L) depending on how many schemes the organisation has data on).

It should be noted that whilst the survey explicitly asked for male rates, the IFoA reports that around 80% of the rates are unisex. As can be seen there was significant variation across schemes and advisers.

This analysis supports that the majority of DB scheme PCLS factors for this scenario are in the region of 16:1 – 20:1, however there are a wide range of factors adopted. As these factors would have been set based on different dates (and reflect a number of different scheme specific considerations), a comparison against the implied factors from the current FG 17/9 Guidance must be treated with caution. However, generally we see that the current FG 17/9 Guidance implies higher commutation factors than used in the market, particularly when discount rates are at their lower levels.

This difference will, at least in part, reflect that the actual rates used in the market may be calculated with a consideration of a longer term financial outlook rather than looking to explicitly take a 'mark-to-market' approach (which is the approach used in the current redress methodology). This provides schemes and members with a degree of stability and predictability that wouldn't be otherwise achieved in the volatile financial markets we have experienced in recent years.



Source: IFoA

[1]www.actuaries.org.uk/upholding-standards/actuarial-monitoring-scheme/publications/pensions-actuarial-factors-used-calculate-benefits-uk-pension-schemes

Assumptions – Post-retirement discount rate

Allowance for Pension Commencement Lump Sum (PCLS)

Given that the majority of members take a PCLS at retirement and that they commonly take the maximum available, we consider it reasonable to assume that the consumers impacted by the redress guidance would also have taken this approach. Therefore we considered it appropriate to make allowance for this within the redress methodology.

An exception to this would be where the original DB scheme provided a separate lump sum at retirement and therefore the member may not have opted to commute any pension to provide a further lump sum. Further discussion on this is given in Section 5g (Assumptions & Methodology: Other) of this Report.

There are 3 methods of allowing for a PCLS which we consider viable and merit consideration:

1. Using the PCLS factors in force in the original DB scheme
2. Using a set table of PCLS factors published as part of the redress methodology
3. Making an adjustment to the post-retirement discount rate (in line with the current approach)

In isolation, the higher the PCLS factor, the higher the level of redress.

Approach 1 – Using the PCLS factors in force in the original DB scheme

Using the factors which would have applied in the DB scheme could be considered to accurately put the consumer in the same position (in relation to cash commutation) they would have been if they hadn't transferred.

Where the DB scheme is still operational, obtaining the factors may not be straightforward and so may also lead to delays in calculating redress.

Further, the PCLS factors obtained would only apply at that specific point in time as the trustees of the DB scheme will regularly review the appropriateness of the scheme factors. As such, the factors obtained may not be suitable for any Prospective Loss cases where the retirement date may still be a number of years in the future.

Approach 2 – Using a set table of PCLS factors published as part of the redress guidance

Using a table of PCLS factors would provide consistency of redress across consumers and removes the data collection issues inherent with Approach 1. These factors could also be kept under review and updated as required if market movements resulted in the factors becoming inappropriate.

Whilst being consistent across consumers, there would ultimately be winners and losers under this approach relative to using the actual factors each consumer would be subject to in the original DB scheme. Given the large variety of benefit structures which would need to be covered, there would need to be a large numbers of factor tables which may become impractical to maintain. It would also require non-trivial updates to redress software to introduce these tables.

Approach 3 – Making an adjustment to the post-retirement discount rate (in line with the current approach)

An adjustment to the post-retirement discount rate will provide a degree of market-linking as the PCLS factors implied by the adjustment will change over time as markets change. Updates to the actual adjustment should be relatively easy to communicate and implement in the future if required.

Assumptions – Post-retirement discount rate

Allowance for Pension Commencement Lump Sum (PCLS)

However, we note that like Approach 2, as this approach does not use the actual cash commutation factors for each DB scheme, there will ultimately be some consumers who are over/under compensated under this approach.

Ultimately in our view Approach 3 (the current approach) is the most pragmatic approach to meeting the FCA's objectives, as it avoids the administrative complexities of Approach 1, whilst achieving a similar outcome as Approach 2 without requiring any updates to redress calculation software.

We acknowledge that the level of adjustment to be made to the initial post-retirement discount rate is somewhat subjective.

As set out earlier in this Section of the Report, the PCLS factors implied by the 1.6% p.a. adjustment are 20.5 to 26.0 for a pension increasing in line with RPI capped at 5% p.a., depending on market conditions.

This can be considered against the IFoA analysis, noting the limitations discussed previously. This analysis supports that the majority of DB scheme PCLS factors for this scenario are in the region of 16:1 – 20:1. We would note that the IFoA analysis does evidence a very wide range of PCLS factors being adopted by DB schemes ranging from 9 to 35.

Whilst the PCLS factors implied by the 1.6% p.a. adjustment are higher than those typically seen in DB schemes, we would note that for Prospective Loss cases, the adjustment is required to reflect PCLS factors at the consumer's retirement age at some point in the future and not necessarily current factors.

There is a gradual trend of PCLS factors in DB schemes increasing over time. In light of this and due to current gilt and inflation markets we would generally expect to see PCLS factors adopted by DB schemes continue to increase over the coming years.

Therefore adopting a level of adjustment which implies higher PCLS factors than the 16:1 – 20:1 range is considered reasonable for Prospective Loss cases. The PCLS factors implied by the 1.6% p.a. adjustment (20.5 to 26.0) are within the range of PCLS factors adopted by DB schemes (9 to 35).

Overall, we consider that the existing adjustment of 1.6% p.a. applied to 25% of the initial post-retirement discount rate assumption continues to meet the FCA's objectives.

Assumptions – Post-retirement discount rate

Overall Conclusions

Overall we do not propose that any amendments are made to the existing approach for setting the post-retirement discount rate assumptions.

Current and Proposed Approach

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 integer term to retirement and the discounted mean term, 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 integer term 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.

An adjustment is also made to the post-retirement discount rate assumption to allow for the option for the consumer to take a pension commencement lump sum.

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%.

This may be modified to reflect actual pension commencement lump sum percentages for actual loss cases or where the pension commencement lump sum was additional to pension income in the original scheme.

See further comments in Section 5g (Assumptions & Methodology: Other) of this Report.

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

Assumed retirement age	55	60	65	70	75
DMT	23	20	16	13	11

Discounted mean terms for other assumed retirement ages up to 65 should be based on linear interpolation and rounded to the nearest integer.

Assumptions – Post-retirement discount rate

Future review

Future review

Given the importance of this assumption to the value placed on DB benefits, we consider that a review of this assumption should be undertaken every four years as a minimum.

We would expect this assumption to be reviewed if there was a significant change to the pricing levels or calculation approach of annuities in the market. This may be caused by a reduction in the number of firms providing individual annuities.

We note there is currently a consultation[1] underway on elements of Solvency II. If the outcome of this leads to significant impact on annuity providers then a review on how this impacts pricing should be undertaken.

Any change to the tax regime underpinning the PCLS available to consumers would require a review of the approach for PCLS, as would any material change in consumer behaviours in respect of PCLS.

[1]www.gov.uk/government/consultations/solvency-ii-review-consultation

5c. Assumptions: Inflation & Inflation Linked

Assumptions – Inflation & Inflation Linked

Current approach

The inflation assumption is used to calculate the assumed rate of revaluation in deferment after the Date of Calculation, as well as the rate of pension increases in payment, in order to derive the capitalised value of the original DB scheme benefits of the consumer.

The current FG 17/9 Guidance sets out the following approaches in regards to setting assumptions for the futures rates of RPI & CPI inflation, and consequently the approach to calculating the rate for pension increases in payment:

RPI Inflation:

Based on the 'UK instantaneous implied inflation forward curve (gilts)' published by the Bank of England to 40 years. This curve is then extrapolated for any term exceeding 40 years, using the average difference between inflation and gilt yields over the terms 35 to 39 years. For any term shorter than 3 years, the 3 year rate is assumed to apply. The RPI Inflation rate for pre- and post-retirement is derived as follows:

- Pre-retirement – by taking the spot rate for the term to retirement
- Post-retirement – by taking the derived forward rates from normal retirement age to the age indicated after adding on the discounted mean term, using the same methodology as the guidance states in relation to the post-retirement discount rate.

The final assumptions should then be rounded to the nearest 0.05%

CPI Inflation:

For redress calculated before 1 January 2021, the CPI Inflation rate is assumed to be the RPI Inflation assumption minus 1%.

For calculations from 1 January 2021 onwards, the pre- and post-retirement CPI Inflation assumption for common assumed retirement ages is provided in Annexes of the FG 17/9 Guidance. For any assumed retirement ages in the range 55-75 not listed in the tables provided, linear interpolation should be used to derive these. Furthermore, for any ages less than 55, or greater than 75, linear extrapolation should be used for derivation of an appropriate rate.

Pension increases in Payment:

This is defined as the relevant pension increase rate together with either the RPI or CPI assumption (depending on the rules of the relevant DB scheme)

- **If the scheme rules impose a cap:** The cap specified by the rules should be used where the relevant inflation assumption is higher than the cap, and the relevant inflation assumption should be used where it is below the cap.
- **If the scheme rules impose a floor:** The floor specified by the rules should be used where the relevant inflation assumption is lower than the floor, and the relevant inflation assumption should be used where it is above the floor.
- Where fixed pension increases are granted under the customer's DB pension scheme, those fixed pension increase rates should be used.

Assumptions – Inflation & Inflation Linked

Key considerations

We consider the following to be key issues to consider in respect of setting inflation assumptions, and the consequent derivation of pension increase assumptions:

- What is the most appropriate initial data source to provide a clear and robust approach to setting the inflation assumptions?
- Is the continued use of the 'UK instantaneous implied inflation forward curve (gilts)' still an appropriate and practical way of determining RPI inflation assumptions, or are alternative approaches more suitable?
- What is the most appropriate approach where the RPI rate at the required term isn't explicitly published?
- Is the continued use of the current discounted mean terms (DMTs) provided in the FG 17/9 Guidance appropriate?
- Should any adjustments be made to the market implied rates, for example to allow for the inclusion of an inflation risk premium?
- How should the CPI inflation assumption be set and can it be future-proofed rather than requiring updated tables to be published annually?
- Should any adjustment be made for pension increase assumptions to reflect the caps and floors that apply?
- How can the risk of inconsistent approaches being adopted in the market for practical elements of applying the inflation assumptions be minimised?

Some elements in the derivation of inflation linked assumptions will be subjective and careful consideration will be needed to reduce the risk of either over or under compensating consumers.

These factors will need to be carefully balanced with the idea of future proofing the approach and limiting the need for regular updates by the FCA.

The revised redress methodology will need to clearly state how assumptions should both be derived and applied in practice to remove the potential for ambiguity.

Key objectives for this set of assumptions include:

- Appropriate redress must, as far as possible, put the consumer into the position they would have been in if they had received compliant advice.
- To take account of factors such as recent and future changes to the pensions landscape, the availability of data, and actuarial standards and best practice to ensure the redress methodology and assumptions are as robust as possible over an extended period of time.
- To ensure consistency of approach between firms carrying out the calculation.
- To ensure clarity and minimise the scope for ambiguity in the application of the methodology and guidance, minimising the risk that the approach to calculating redress can be misinterpreted or manipulated.
- To enable those who undertake redress calculations or provide redress software to understand the rationale behind the methodology and assumptions and be able to apply it readily in practice.

Assumptions – Inflation & Inflation Linked

Setting a baseline RPI inflation assumption

There is a deep market in financial instruments linked to the Retail Prices Index ("RPI") that can be used to measure market expectations of future RPI inflation.

Currently the Bank of England ("BoE") published rates are used in the FG 17/9 Guidance. The published rates reflect an RPI inflation assumption set in line with the difference between fixed interest and index-linked gilts (i.e. market implied breakeven RPI inflation).

The BoE published rates are freely available from the BoE website[1] and provide an easily accessible reference for market implied RPI inflation. Other methods of setting inflation rates may be possible (such as considering swaps or other market data), however we consider that the BoE published rates meet the FCA's objectives and therefore we have not considered alternative approaches further.

We acknowledge that insurance companies may actually use swaps data when setting inflation assumptions for annuity pricing purposes. However, consistent swaps data is not readily and freely available and therefore we do not propose that swaps data is used to derive the RPI inflation assumption.

The BoE rates are generally published for terms from 2.5 years to 40 years (inclusive) in 6 monthly increments, albeit there have been occasions when the very short terms have not been published for particular dates.

Whilst some inconsistency was noticed in the data's ultimate use, information supplied by the FCA illustrated that Redress Providers are able to access this BoE inflation rate data, and have clarity over which data item to select.

We consider the continued use of the 'UK instantaneous implied inflation forward curve (gilts)' published by the BoE meets the FCA's objectives.

The current approach of using spot rates for pre-retirement, and forward rates (derived from assumed retirement age based on a weighted average payment term) for post-retirement is also considerate appropriate.

We propose two clarifications to the redress methodology to reduce the risk of different approaches being taken in the market:

- When determining the spot rate for pre-retirement, the term to retirement should be the integer term to retirement; there should be no interpolation of the BoE rates, nor the use of the 0.5 year rates (with the exception of very short terms as discussed on the next page).
- The BoE rates should be taken exactly as published, there should be no amendments made to these (for example, to annualise the rates).

We have commented on the Discounted Mean Terms (DMTs) currently used in the FG 17/9 Guidance within Section 5b (Assumptions: Post-retirement Discount Rate) of this Report and those comments equally apply to the derivation of the post-retirement inflation assumptions.

As noted in that section, we support the continued use of published DMTs for the derivation of forward rates. Those factors are considered appropriate for use in the derivation of the RPI inflation assumptions.

As noted on the left, the BoE rates are published from 2.5 years to 40 years and therefore it may be necessary to derive rates outside of these ranges.

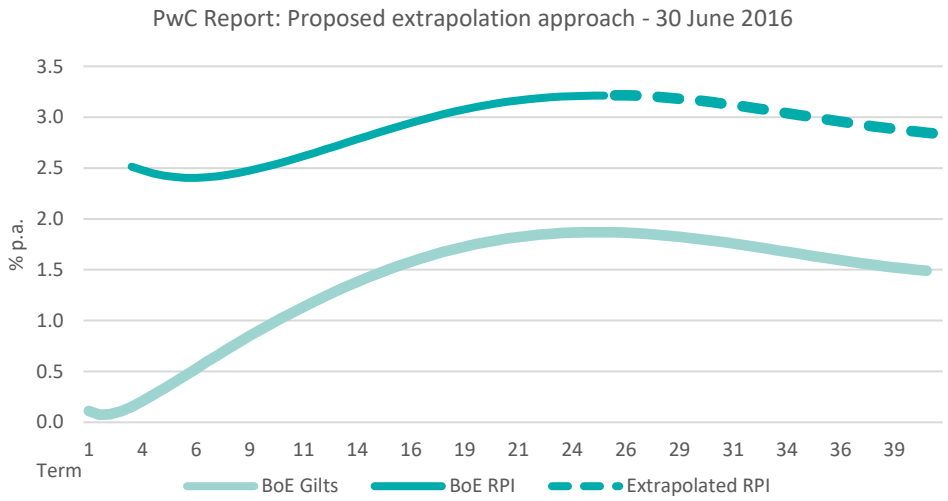
The current FG 17/9 Guidance states that the BoE inflation curve is extrapolated for any term exceeding 40 years, using the average difference between inflation and gilt yield curves over the terms 35 to 39 years. For any term shorter than 3 years, the 3 year rate is assumed to apply. We propose changes to this element of the approach as we consider that there is a lack of clarity on how the rate over 40 years should be derived. Further details are set out on the next page.

[1] www.bankofengland.co.uk/statistics/yield-curves

Assumptions – Inflation & Inflation Linked

Setting a baseline RPI inflation assumption – approach at short and long terms

In order to derive an RPI rate for terms over 40 years, the current approach would require the calculating firm to obtain a gilt rate in excess of 40 years and add the 35-39 year average difference (between inflation and gilt yield curves) to this. This broad approach was originally set out in the PwC Report in 2017. However at that time the BoE inflation rates were only published to a term of 25 years, as illustrated in the graph below. Therefore the extrapolation utilised the gilt rates published from 25 to 40 years.



Gilt rates in excess of 40 years are not freely available and this could lead to inconsistency of approaches being adopted in deriving an RPI rate for terms over 40 years.

We are not aware of the precise approaches currently being taken by Redress Providers in this situation, however we expect some will simply be maintaining the longest gilt rate freely available (40 years) or the longest BoE inflation rate at 40 years.

We propose that the approach in the redress methodology is updated to remove the potential for inconsistency. We consider that there are two options for the extrapolation of inflation rates for terms in excess of 40 years:

1. Maintain the 40 year BoE implied inflation rate. This would provide a simple and practical option with no risk of ambiguity. It would however potentially lead to a lower level of accuracy for calculations impacted by these terms.

2. Derive rates using an extrapolation technique based on the average slope of the inflation curve at the longer terms.

There will be a number of potential approaches to extrapolate beyond 40 years, some more mathematically complex than others. We consider that any mathematically complex approaches are unlikely to be easily understood and risk being applied inconsistently across the industry. This could also present challenges for software providers. We expect this would only impact a small number of cases which require rates at terms in excess of 40 years.

In light of the small number of potential cases likely to be impacted, and the small benefit which a more complex mathematical method would provide, we propose that the more simple and practical option of maintaining the 40 year BoE implied inflation rate better meets the FCA's objectives.

At the shorter terms we propose the redress methodology is updated to state that where a term shorter than that published is required, the next available rate should be adopted. This would provide a level of future proofing if the BoE change the terms published. This would allow the use of the 2.5 year term rates rather than 'stepping over' this to the 3 year rate. We note that this could appear 'inconsistent' with the proposal for pre-retirement inflation to not use the 0.5 year rates. However, we consider the use of the 2.5 year rate appropriate for terms under 3 years as this is the most relevant data point (particularly due to the current shape of the inflation curve at shorter terms).

Assumptions – Inflation & Inflation Linked

Adjustments to 'break-even' inflation

Typical actuarial practice is to set RPI inflation based on break-even inflation with an adjustment, known as the Inflation Risk Premium ("IRP"), to allow for other non-inflation factors contained in break-even inflation (for example, investors paying a premium for protection against inflation and/or an under-supply of index-linked gilts).

The RPI inflation assumption is derived by deducting the IRP from the break-even inflation rate. Historically, actuaries have adopted an IRP in the range 0% p.a. to 0.3% p.a. The latest evidence suggests that a wider range of IRPs can now be justified than has historically been the case. We note that setting an IRP now requires more judgement than has previously been the case.

Part of this evidence relates to the impact of the UK Statistics Authority's ("UKSA") announcement on 4 September 2019 that it intends to reform the RPI to bring it into line with CPI including owner occupiers' housing costs ("CPIH"). The UKSA could not make this change until at least 2030, without the consent of the Chancellor of the Exchequer. The then Chancellor confirmed that he was not prepared to consent to the change until at least 2025, and announced a consultation that considered the timing and methodology of the change. On 25 November 2020, the UKSA and Chancellor confirmed the change would occur in 2030.

The market reaction to the announcements was less than the full amount of the expected change to RPI and break-even inflation has significantly diverged from RPI swaps, market forecasts and the Bank of England's 2% target for inflation. The level of divergence varies by the term of break-even inflation (i.e. at some points on the break-even inflation curve there is less of a divergence and at other points there is greater divergence). This implies non-inflation factors exist in the break-even inflation rates, and are different at different terms.

Further, there are significant supply and demand issues with the underlying fixed interest gilts and RPI index-linked gilts markets on which break-even inflation is based. For example, as at 30 September 2020, there were £445bn of index-linked gilts in issuance and £1,280bn of fixed-interest gilts in issuance. At this date, 29.4% of all gilts were held by insurers and pension schemes, 28.5% were held by the Bank of England under the Asset Purchase Facility and the remaining 42.1% were predominantly held by overseas investors and financial institutions. The total gilts in issuance is significantly smaller than the size of UK DB pension scheme liabilities (over £2,300bn according to the PPF on a buy-out consistent basis at 31 March 2020).

Given the majority of UK DB pension scheme liabilities are inflation linked, the potential demand for index-linked gilts from just pension schemes is up to around five times the index-linked gilts in issuance. In practice, we understand index-linked gilts are also sought after by insurers and other investors and so the demand is likely to be higher. This over-demand/under-supply is another cause of the non-inflation factors contained in break-even inflation.

Overall, these market expectations and reactions imply that an IRP is likely to exist, but give little information as to the exact quantum of the IRP. Setting an IRP therefore requires significant judgement. The current FG 17/9 Guidance makes no allowance for an IRP.

Our view is that the current market evidence supports that an IRP greater than 0% is now more justified than has historically been the case. On the next page we consider methods of setting an IRP appropriate for the revised redress methodology.

Assumptions – Inflation & Inflation Linked

Adjustments to 'break-even' inflation – setting an IRP

As noted, setting an IRP requires judgement. There is significant uncertainty in the market and there are a wide variety of opinions over the level of an IRP. There is therefore no single market derived IRP that could be adopted for redress purposes.

When setting an IRP assumption, a number of market indicators should be considered, including:

- Breakeven RPI inflation;
- Swap market RPI implied inflation;
- The Bank of England's 2% CPI inflation target;
- Calculation differences between RPI, CPI and CPIH; and
- Short and long term inflation forecasts (from the Office for Budget Responsibility, the Bank of England and Consensus Economics)

Based on these forecasts, it is possible to develop a range of IRP curves that we believe could reasonably be considered as best estimates.

Our analysis supports the existence of a non-zero term dependent IRP which reflects the current uncertainty around inflation and the future changes to RPI. Under this scenario, single equivalent IRPs (i.e. converting the term dependent rates into a single rate) may range from 0% to 1.5% p.a. depending on the nature of the cashflows being considered.

This range is higher than previous periods due to the market expectations of short term inflation. Setting a larger IRP places more reliance on actuarial judgement and economic theory rather than market observable statistics and there is an increased risk associated with this.

Whilst it would provide a more theoretically correct calculation of redress, implementing a term dependent IRP in the revised redress methodology is not considered to be a practical approach and would need regular monitoring and review. On balance, our view is that it therefore does not meet the objectives of the FCA.

However, making no allowance for an IRP implicitly assumes an IRP of 0%, which we do not consider to be appropriate and could lead to over-compensating consumers.

We therefore propose a practical approach of including a single flat IRP. The exact level to set this at requires judgement. We consider an IRP of 0.2% represents a fair balance of not knowingly over or under compensating consumers when taken as a whole.

We therefore consider an allowance for an IRP of 0.2% applied to RPI inflation for pre-retirement meets the FCA's objectives. No adjustment is applied for post-retirement inflation.

Any adjustments would only apply to the pre-retirement inflation assumptions, as annuity providers would typically be hedging inflation risk using market linked instruments. Annuity providers would therefore not typically be including an IRP in their reserving or pricing bases. It should therefore not be included in the post retirement RPI inflation assumption. This remains based purely on the BoE implied rates.

This IRP assumption is likely to require periodic review regardless of the approach taken due to inherent uncertainty in inflation markets. Given the changes to RPI proposed in 2030 (c.8 years' time), we consider this is an appropriate time for a review with an interim review undertaken in 4 years' time.

Assumptions – Inflation & Inflation Linked

Setting a CPI inflation assumption

There are differences in the determination of RPI and CPI, both in the method of calculation and the goods covered by the indices.

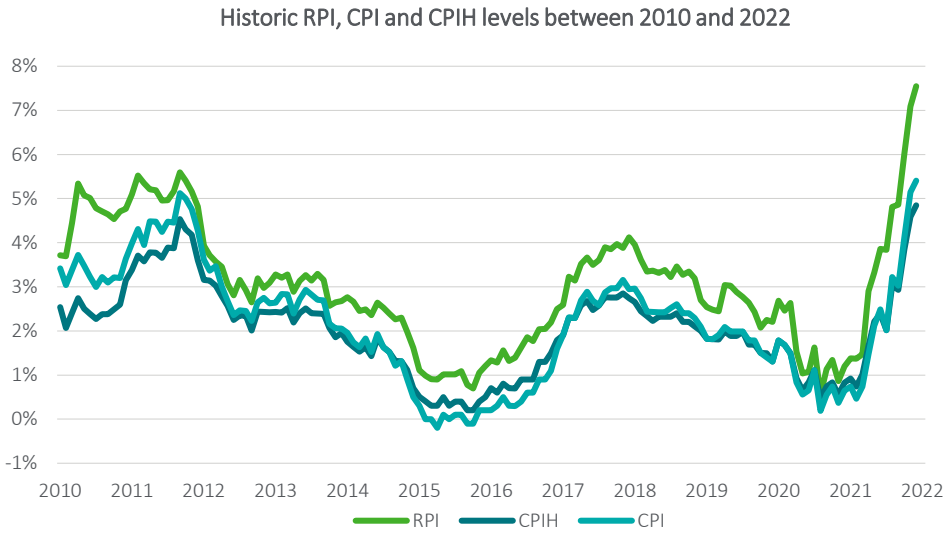
Unlike RPI inflation, there is currently no market measure of future CPI inflation. The assumption for RPI inflation is often therefore used as the starting point for determining a suitable CPI inflation assumption. Albeit noting that some advisers are starting to move away from the traditional approach of setting CPI by a deduction to RPI, instead focusing on the BoE's targeted long term inflation level of 2% p.a.

Whilst this has some merit, it doesn't provide a term dependent assumption, noting that this target of 2% p.a. is expected to be challenging to achieve over the next few years given the current levels of inflation. We therefore continue to favour a deduction or 'wedge' applied to the RPI assumption (including any IRP applied).

As noted previously, RPI is proposed to be bought in line with CPIH from 2030 and therefore any wedge should reflect this. Currently a table of 'wedges' are provided as an Annex to FG 17/9 which are based on the principle of a 1% difference/'wedge' pre 2030, 0.5% difference in 2030 and 0% post 2030.

Whilst there is a small difference in the calculation methodology of CPI and CPIH, these two measures have been very similar over the last few years and so we would not propose to make any explicit allowance to reflect this difference. The graph on the right shows the relative levels of RPI, CPI and CPIH since 2010.

We consider that the current approach of a 1% difference/'wedge' pre 2030, and 0% post 2030 remains appropriate. The theoretical 'wedge' close to 2030 will be more complex than a simple 0.5% wedge in 2030, however we view this approach as pragmatic and see no compelling reason to alter this.



We consider it appropriate to use a formula based approach instead of a table based approach when deriving CPI, as it is more future proofed than the current approach of updating the 'wedges' table periodically.

In order to make the formula easy to understand (and so to reduce the risk of inconsistent application) it may be appropriate to accept a loss of accuracy in the calculation. For example forgoing the potential use of forward rates or geometric averaging. The difference on redress of adopting a simple approach is likely to be small once the assumption has been rounded.

We continue to consider it appropriate to use slightly different approaches for the pre and post-retirement CPI assumptions reflecting the different terms these will apply over.

Proposed formulae for calculating both pre- and post-retirement CPI are detailed on the following page.

Assumptions – Inflation & Inflation Linked

Setting a CPI inflation assumption

Proposed formulae for calculating both pre- and post-retirement CPI are set out below.

CPI: Pre-Retirement

- For calculations with an effective date in year 20YY
- For a consumer with term to retirement of x years where 0 < a ≤ x < b (with a and b the integer values either side of x)

RPI - CPI gap for pre-retirement inflation:

If 20YY + a ≤ 2030: 1%

$$\boldsymbol{Else} = \frac{[\mathbf{1}\% \times (\mathbf{2030} - \mathbf{20YY})] + \mathbf{0.5}\%}{\boldsymbol{a}}$$

CPI: Post-Retirement

- For calculations with an effective date in year 20YY
- For a consumer with term to retirement of x years where a ≤ x < b (with a and b the integer values either side of x)
- For a consumer retiring at an age with associated DMT = d

RPI - CPI gap for post-retirement inflation:

If 20YY + a > 2030: 0%

$$\boldsymbol{Else} = \frac{[\mathbf{1}\% \times (\mathbf{2030} - \mathbf{20YY} - \boldsymbol{a})] + \mathbf{0.5}\%}{\boldsymbol{d}}$$

The (unrounded) RPI - CPI gap for pre-retirement inflation should be applied to the relevant unrounded RPI rate. The final CPI assumption should then be rounded to the nearest 0.05% at the end.

Where 'a' equals 0 (i.e. the term to retirement is less than one year), no pre-retirement inflation assumptions are required.

These RPI – CPI gaps would be applied to the respective Pre and Post-Retirement RPI assumptions.

Example 1

For a calculation in the year 2023. For a consumer with term to retirement of 5 years 6 months, retiring at age 65

Pre-Retirement CPI wedge:

2023 + 5 = 2028 which is less than 2030, therefore Wedge = 1%

Post retirement CPI wedge:

Wedge = $\frac{[1\% \times (2030-2023-5)]+0.5\%}{16}$ = 0.1563%

Example 2

For a calculation in the year 2022. For a consumer with term to retirement of 11 years 3 months, retiring at age 60

Pre-Retirement CPI wedge:

2022 + 11 = 2033 which is more than 2030, therefore:

Wedge = $\frac{[1\% \times (2030-2022)]+0.5\%}{11}$ = 0.773%

Post retirement CPI wedge:

2022 + 11 > 2030 therefore Wedge = 0%

Assumptions – Inflation & Inflation Linked

Pension Increases in Payment

A DB scheme's rules will set out the pension increases which apply to members' benefits. Generally speaking, various increase rates will apply to different portions of pensions in payment, depending on when and under which section/scheme they were accrued.

Some elements of pension may receive increases in line with RPI/CPI inflation subject to various caps and floors. For example, an LPI5 (Limited Price Indexation) increase may be applied, where the increases are subject to a maximum of 5% p.a. with a minimum of 0% p.a.

Where pensions are increased in line with RPI/CPI inflation subject to minimum or maximum rates, a common approach is for an adjustment to be made for the impact of these minimums and maximums when setting the pension increase assumption. We understand that this is the approach which an insurer would take when pricing annuities and indeed this can be seen by comparing annuity prices for an annuity linked to pure RPI and one linked to LPI.

There are many different increase rates which will exist across DB schemes and any approach in the redress methodology needs to be appropriate for these. For example we are aware that one current redress calculation software programme makes allowance for c.15 different increase types.

Pension increases in deferment (i.e. revaluation) are usually based on inflation capped over the whole revaluation period, therefore the comments here about annual caps and floors will not be applicable. However, where schemes do provide revaluation based on an annual cap, the comments made here in respect of pension increases in payment will apply.

Current approach

The current FG 17/9 Guidance states:

- Pension increases in Payment: This is the relevant pension increase assumption together with either the RPI inflation assumption or the CPI inflation assumption (depending on the rules of the relevant DB Scheme)
- 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. The relevant inflation assumption should be used where it is below the cap.
- 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. The relevant inflation assumption should be used where it is above the floor.
- Where fixed pension increases are granted under the consumer's DB pension scheme, those fixed pension increase rates should be used.
- If similar caps and floors apply to the revaluation rates used in deferment then the same approach should be used as for increases to pensions in payment.

Assumptions – Inflation & Inflation Linked

Pension Increases in Payment

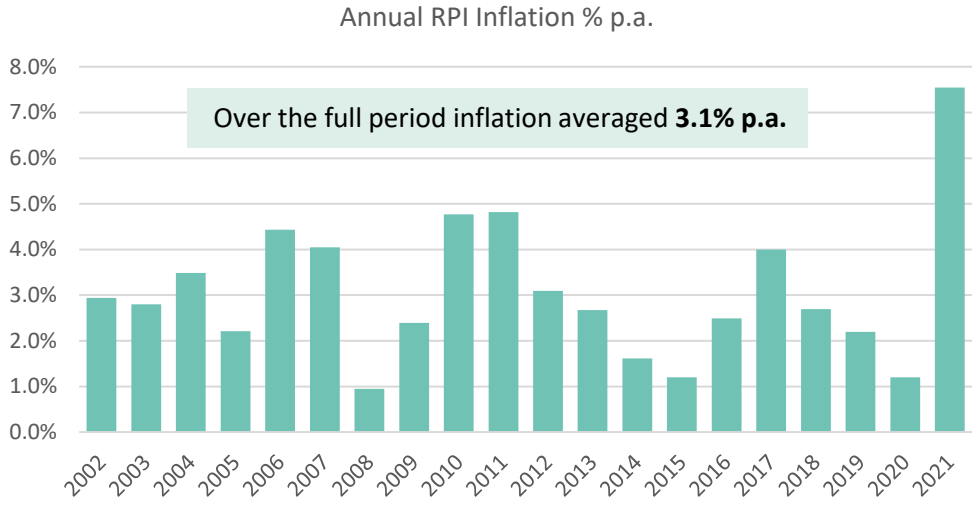
The current approach makes a simple allowance for the relevant caps and floors applying to the pension increases. An alternative common approach is to reflect the volatility of the inflation assumption and therefore reflect the chance of inflation hitting these caps and floors in future years. This is an approach which insurance companies will be considering when setting annuity pricing, with volatility factored into their internal bespoke models.

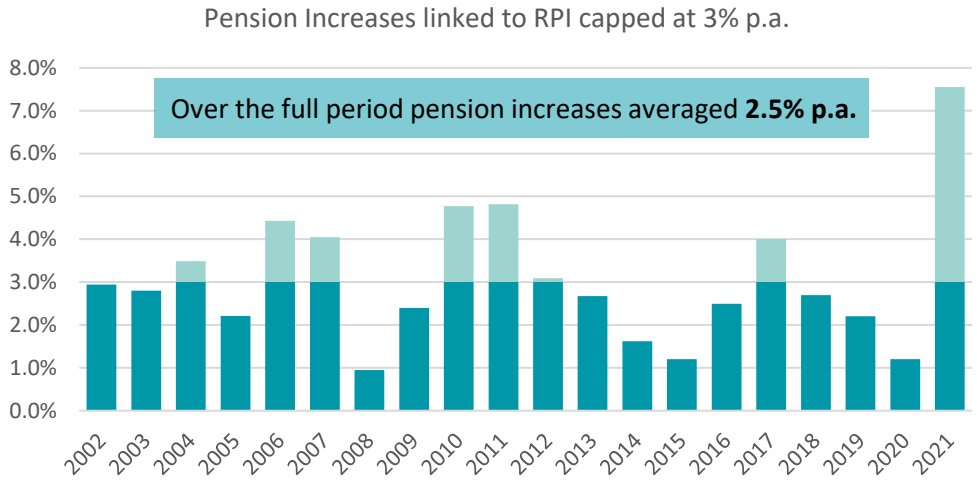
For example, a market implied inflation rate of 2.9% p.a. at a term of 20 years is based on the expectation that the actual annual inflation rate fluctuates around this but averages out to 2.9% p.a. Therefore inflation will be above and below this average rate at certain points of time. As pension increases in payment are capped each year, any time the inflation is above a cap of say 3.0% then the increase will be limited to 3.0%. Therefore over the 20 year term the pension increase rate will average less than 2.9% and an adjustment will be appropriate.

The top graph opposite shows the annual RPI inflation rates over the 20 years to 2021 (December months used). The bottom graph opposite shows the increases which would have been awarded to a pension linked to RPI inflation but capped at 3% p.a.

As can be seen in the graphs the impact of the 3% cap has had a material impact on the actual increases applied to the pension reducing to an annualised average rate of 2.5% p.a.

If the same inflation pattern was to occur in the future, then under the existing FG 17/9 Guidance the pension increase assumption of 3.0% (i.e. equal to the cap) would overstate the pension increase rate.





Assumptions – Inflation & Inflation Linked

Pension Increases in Payment

In our view, an allowance being made for the volatility of inflation when setting the pension increase assumption better meets the FCA's objectives. As noted earlier, we understand from insurers that they would make an adjustment when setting these assumptions and therefore, we expect annuity pricing to reflect such adjustments. Whilst there are a variety of increases, we expect the maximum limits to have a greater impact than the minimum limits and therefore it is likely the current approach is overall overstating redress. Making an adjustment is a common and standard approach used by actuaries to improve the accuracy of these assumptions and would strengthen an area of the FG 17/9 Guidance that is in our view currently overly simplified.

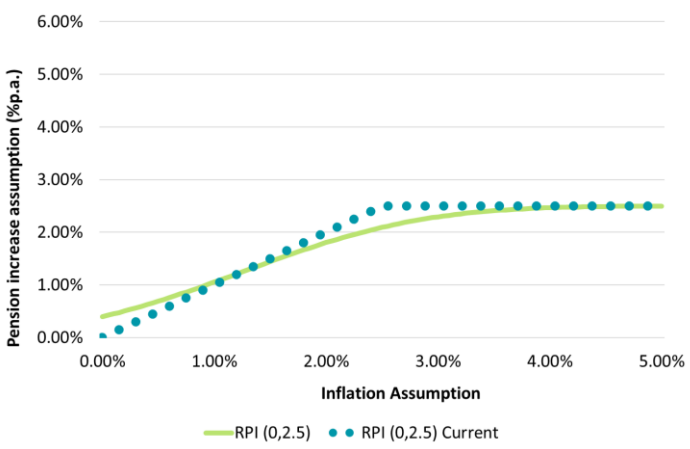
Whilst there will be different models used by actuarial advisers, generally we expect they will produce a consistent output based on an inflation volatility assumption. We consider a version of the Black Scholes model to be a widely used approach.

This Black's model is a deterministic statistical model that can be undertaken using standard spreadsheet operations, with details of its operation freely available online. Details of this model are provided in Appendix 3, which show that an assumption for inflation volatility is required. This is the key input.

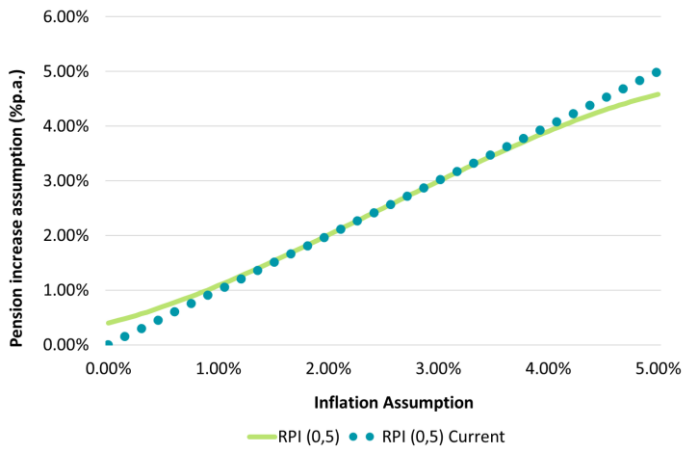
Setting an inflation volatility assumption contains an element of subjectivity and different advisers will have different views. We see rates between 1.0% - 2.5% being commonly adopted in the market.

Using a Black's model to set a pension increase assumption will result in a different assumption compared to the existing approach. The extent of this difference will depend on the level of inflation and the exact nature of the pension increases. The graphs below show the difference between the existing approach and a possible inflation volatility driven Black's model with volatility of 1.0%. The final assumptions would be rounded to the nearest 0.05% so won't be as smooth as shown below. We have shown three pension increases below.

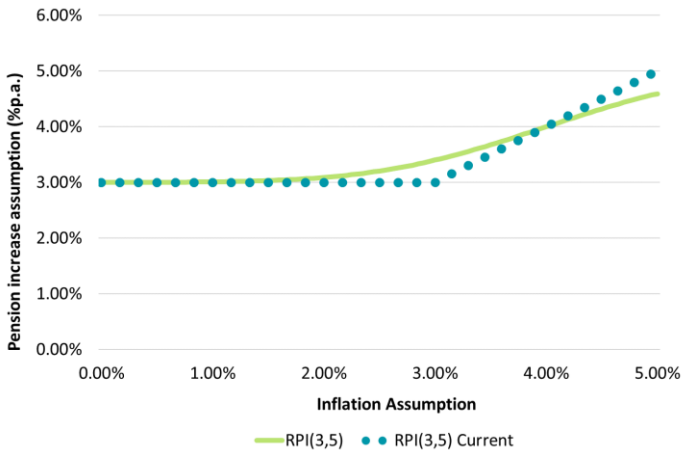
RPI linked minimum 0%, maximum 2.5% - RPI (0,2.5)



RPI linked minimum 0%, maximum 5% - RPI (0,5)



RPI linked minimum 3%, maximum 5% - RPI (3,5)



Assumptions – Inflation & Inflation Linked

Pension Increases in Payment

This graphs on the previous page show the variability of the impact of the alternative approach relative to the current approach and could result in higher or lower pension increase assumptions depending on the pension tranche and the prevailing inflation assumptions. The alternative approach could therefore result in both increases and decreases in redress amounts depending on the consumer.

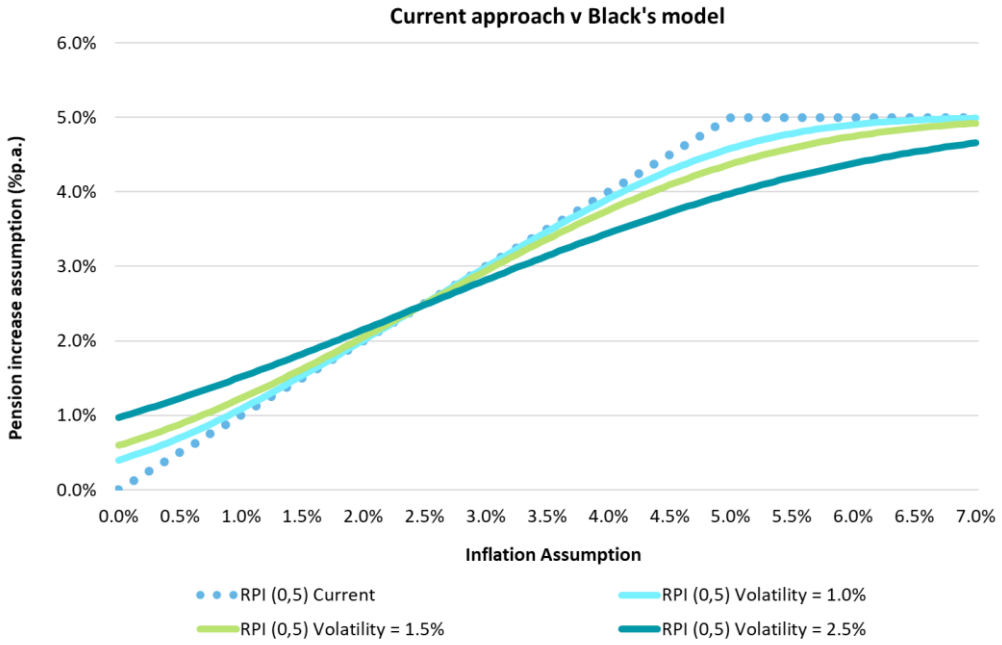
Overall, based on our experience of the most common pension increases and current inflation levels, we would expect an overall decrease in redress by adopting this alternative approach.

Setting the inflation volatility level

The graph on the right shows the impact on the RPI pension increase (subject to minimum of 0% and maximum 5%) assumption of adjusting the volatility assumption within the Black's model. The greater the volatility, the greater the adjustment we would expect to see applied to the market implied inflation rate.

Different actuaries will have different views on an appropriate inflation volatility assumption to use to derive pension increase assumptions and there is no single market derived rate which can be linked to. Therefore it would be necessary for the FCA to specify a rate to be used in redress calculations. Looking to base a volatility assumption on past data leads to the need for judgements on elements such as the time period to consider, the term of inflation to use and the use of daily or annual volatility figures. Therefore any rate set by the FCA will reflect an element of judgement.

As noted earlier, we see volatility rates between 1.0% - 2.5% being common in the market and would propose a rate in this range. A rate of 1.0% would lead to assumptions which were closest to the existing guidance and therefore provides a balance of increased accuracy and 'inter-generational' fairness.



Assumptions – Inflation & Inflation Linked

Pension Increases in Payment

Considerations of implementing a volatility based approach

Adopting a volatility based approach would be a material change to the current methodology used for this part of the redress calculation. If this approach was to be adopted, there are a number of considerations and challenges which would need to be addressed.

- Understanding of the approach: Whilst this is a standard statistical method and a common approach used in various financial fields, it would be difficult for a typical consumer to understand the mechanics of it and why it was a suitable method, particularly as it will most likely reduce redress. Redress Providers will also need to understand the method in order to implement it appropriately.
- Updating software: Introducing this approach would require software providers to update the software to be able to calculate the required assumptions. As noted earlier, the Black's model is a deterministic statistical model that can be undertaken using standard spreadsheet operations, with details of its operation freely available online. However, it does require links to the Normal Distribution tables and calculations to be undertaken in respect of these. Introducing this into software therefore might not be a simple task for providers.

In Appendix 3 we have set out details of how this Black's model works and it's integration with the Standard Normal Distribution. This, alongside our sample calculations could be used to test the ability of the market to adopt this alternative approach as part of the consultation.

If it is apparent that adopting the alternative approach would not be feasible across the market, then the FCA may consider that it is not appropriate to include it in the updated redress methodology.

If adopting an approach in line with a Black's model is not considered appropriate then we have considered other options that could be used for pension increase assumptions. These include:

- Publishing a table of adjustments to the inflation rate for various benefit structures: These could work similarly to the CPI differential table used in the current FG 17/9 Guidance and require the redress calculator to look up the adjustment based on the derived RPI or CPI assumption.
- Producing a formula based approach which calculates a simple adjustment based on the proportional proximity of the derived inflation assumption to a cap or floor.

Having considered these options, we do not consider that they provide an appropriate balance of increased accuracy versus computational or presentational complexity. We therefore would not propose that they are adopted as they do not meet the FCA's objectives.

Whilst the current approach is likely to overstate redress in certain cases it does have the benefit of being simple to understand, implement and explain. Therefore, should a Black's approach (or similar) not be considered feasible, we would propose that the current approach is maintained.

Assumptions – Inflation & Inflation Linked

Further considerations

Short term inflation levels

UK inflation is currently at levels which have not been seen for over three decades. Supply chain disruptions, volatile energy costs and pent-up demand following the COVID-19 pandemic will be contributing to this. The situation in Ukraine will also have added more inflationary pressure.

The anticipated short term high levels of inflation will be factored into the BoE inflationary curves used in redress calculations. However, as noted previously these curves only start at a term of 2.5 years and so the levels of inflation over the next two years would not be explicitly included, for example if a 1 year term to retirement was required. Further, the unusually high levels of inflation will also impact the levels of Inflation Risk Premium present in the market implied rates and inflation volatility levels. We have proposed long term assumptions for these which are not directly market linked, therefore they do not explicitly reflect the current high inflation environment over the short term.

In the medium term, inflation is expected to return to more moderate levels. This is reflected in the shape of the BoE inflation curve and consistent with the BoE target of 2% for CPI. Generally we therefore consider the overall approach set out in this Report to remain appropriate in the current inflationary environment.

Any short term 'patch' for short term inflation values would have the following challenges:

- Any patch is likely to be subjective in nature and not directly market linked.
- The inflation situation could change quickly and so it is unclear on how long any patch would remain valid.
- The derivation of the pre-retirement discount rate includes the assumption used for CPI. Therefore there is a degree of offsetting of the impact pre-retirement (for benefits with inflation linked revaluation in deferment) on the redress value.

We therefore do not consider that any specific adjustment would be in line with the FCA's objectives at this stage, however the FCA may wish to keep this under review.

Assumptions – Inflation & Inflation Linked

Further considerations

Areas of potential inconsistency

Following discussions with the FCA, we are aware of a number of areas where potential inconsistencies have been highlighted in the approaches taken by different Redress Providers in the market. We set out below the approach that we would expect to be adopted in these scenarios. We note that these relate to the methodology for calculating the value of benefits rather than the specific inflation assumptions which should be adopted.

We may expect that this level of granularity is beyond the scope of the updated redress methodology, however these comments are provided to help improve consistency in future calculations.

- Unknown DB scheme approach: Whilst we would expect Redress Providers to obtain sufficient detail on the DB scheme's benefits to produce materially accurate calculations, there may be small elements of the benefits or administration practices which are unclear. Whilst this may cover a wide range of elements, in general in these scenarios we would expect calculations to be undertaken in line with statutory minimum requirements unless there is evidence to support more generous benefits.
- Negative inflation for deferred revaluation: Unless overridden by specific scheme requirements we would expect benefits linked to inflation in deferment to be increased by the inflation index over the whole period of revaluation rather than looking at a year by year assessment. Therefore an individual year of negative inflation in the period should not be adjusted for.

Assumptions – Inflation & Inflation Linked

Overall Conclusions

Overall we propose some small amendments to the existing approach for setting the RPI inflation assumption to better meet the objectives set out earlier.

Current Approach

RPI Inflation: Based on the 'UK instantaneous implied inflation forward curve (gilts)' published by the Bank of England to 40 years.

This curve is then extrapolated for any term exceeding 40 years, using the average difference between inflation and gilt yield curves over the terms 35 to 39 years.

For any term shorter than 3 years, the 3 year rate is assumed to apply. The RPI Inflation rate for pre- and post-retirement is derived as follows:

- Pre-retirement – take the spot rate for the term to retirement
- Post-retirement – take the derived forward rates from normal retirement age to the age indicated after adding on the discounted mean term, using the same methodology as the guidance states in relation to the post-retirement discount rate.

The final assumptions should then be rounded to the nearest 0.05%

Proposed Approach

RPI Inflation: Based on the 'UK instantaneous implied inflation forward curve (gilts)' published by the Bank of England to 40 years.

For terms greater than 40 years, the 40 years rate should be used.

For terms shorter than that published, the next available rate should be adopted. This includes the use of the 2.5 year term rates rather than 'stepping over' this to the 3 year rate.

- Pre-retirement – take the spot rate for the term to retirement (specifically, the number of integer years to retirement). A deduction of 0.2% should be made for an Inflation Risk Premium.
- Post-retirement – take the derived forward rates from assumed retirement age to the age indicated after adding on the discounted mean term, using the same methodology as the guidance states in relation to the post-retirement discount rate.

The final assumptions should then be rounded to the nearest 0.05%. Note, where the RPI rate is used in the derivation of other assumptions (including CPI, pension increases and pre-retirement discount rate), the unrounded RPI rate should be used.

Assumptions – Inflation & Inflation Linked

Overall Conclusions

Overall we propose amendments to the existing approach for setting the CPI inflation assumption to better meet the objectives set out earlier.

Current Approach

CPI Inflation: For any redress calculations before 1 January 2021, the CPI Inflation rate is assumed to be RPI Inflation minus 1%.

For all other calculations, the pre- and post-retirement CPI Inflation assumption for common assumed retirement ages is provided in Annexes of the guidance. For any retirement ages in the range 55-75 not listed in the table provided, linear interpolation should be used to derive these. Furthermore, for any ages less than 55, or greater than 75, linear extrapolation should be used for derivation of an appropriate rate.

Proposed Approach

CPI: Pre-Retirement

- For calculations with an effective date in year 20YY
- For a consumer with term to retirement of x years where 0 < a ≤ x < b (with a and b the integer values either side of x)

RPI - CPI gap for pre-retirement inflation (deferred revaluation):

If 20YY + a ≤ 2030: 1%

$$\boldsymbol{Else} = \frac{[\mathbf{1\%} \times (\mathbf{2030} - \mathbf{20YY})] + \mathbf{0.5\%}}{\boldsymbol{a}}$$

CPI: Post-Retirement

- For calculations with an effective date in year 20YY
- For a consumer with term to retirement of x years where a ≤ x < b (with a and b the integer values either side of x)
- For a consumer retiring at an age with associated DMT = d

RPI - CPI gap for post-retirement inflation (pension increases):

If 20YY + a > 2030: 0%

$$\boldsymbol{Else} = \frac{[\mathbf{1\%} \times (\mathbf{2030} - \mathbf{20YY} - \boldsymbol{a})] + \mathbf{0.5\%}}{\boldsymbol{d}}$$

The (unrounded) RPI - CPI gap should be deducted from the relevant unrounded RPI rate. The final CPI assumption should then be rounded to the nearest 0.05% at the end

Assumptions – Inflation & Inflation Linked

Overall Conclusions

Overall we propose amendments to the existing approach for setting the pension increase in payment assumptions to better meet the objectives set out earlier.

Current Approach

Pension increases in Payment: This is defined as the relevant pension increase assumption together with the either the RPI or CPI assumption (depending on the rules of the relevant DB Scheme)

- **If the scheme rules impose a cap:** The cap specified by the rules should be used where the relevant inflation assumption is higher than the cap, and the relevant inflation assumption should be used where it is below the cap.
- **If the scheme rules impose a floor:** The floor specified by the rules should be used where the relevant inflation assumption is lower than the floor, and the relevant inflation assumption should be used where it is above the floor.
- If the scheme grants fixed increases in payment, then those fixed rates should be used.

Proposed Approach

Pension increases in Payment: This is defined as the relevant pension increase assumption together with either the RPI or CPI assumption (depending on the benefits of the relevant DB Scheme).

- If the scheme imposes a cap and/ or a floor: The pension increase assumption should be derived using a standard Black's model with an inflation volatility of 1.0%. The final assumption should be rounded to the nearest 0.05%.
- If the scheme grants fixed increases in payment, then those fixed rates should be used.

Assumptions – Inflation & Inflation Linked

Impact on assumptions

The tables below show the impact on the inflation linked assumptions of the proposed changes. Assumptions shown in blue boxes are where the proposed changes to the existing approach result in different final assumptions. We note some elements within calculations may have changed but ultimately not resulted in a different assumption due to rounding.

The figures below are for a consumer currently aged 55 with a retirement age of 65.

Assumptions Date	RPI post retirement		RPI pre retirement		CPI post retirement		CPI pre retirement		Post retirement Pension increases for RPI linked, min 0% max 5%		Post retirement Pension increases for RPI linked, min 0% max 2.5%	
	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach
31/03/2022	3.45%	3.45%	4.25%	4.05%	3.45%	3.45%	3.30%	3.20%	3.45%	3.45%	2.50%	2.40%
31/12/2021	3.30%	3.30%	3.85%	3.65%	3.30%	3.30%	2.90%	2.70%	3.30%	3.25%	2.50%	2.35%
30/09/2021	3.45%	3.45%	3.85%	3.65%	3.45%	3.45%	2.90%	2.70%	3.45%	3.45%	2.50%	2.40%

The figures below are for a consumer currently aged 45 with a retirement age of 70.

Assumptions Date	RPI post retirement		RPI pre retirement		CPI post retirement		CPI pre retirement		Post retirement Pension increases for RPI linked, min 0% max 5%		Post retirement Pension increases for RPI linked, min 0% max 2.5%	
	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach	Current Approach	Proposed Approach
31/03/2022	2.70%	2.70%	3.80%	3.60%	2.70%	2.70%	3.40%	3.25%	2.70%	2.70%	2.50%	2.20%
31/12/2021	2.35%	2.35%	3.55%	3.35%	2.35%	2.35%	3.15%	2.95%	2.35%	2.35%	2.35%	2.00%
30/09/2021	2.80%	2.80%	3.65%	3.45%	2.80%	2.80%	3.25%	3.05%	2.80%	2.80%	2.50%	2.25%

Assumptions – Inflation & Inflation Linked

Impact on assumptions

The table below shows the impact on the value placed on the DB scheme benefits of the changes proposed for the inflationary assumptions in isolation for a selection of example consumers. All other assumptions/methodologies have been maintained in line with the current FG 17/9 Guidance. Details on the example consumers we have considered are set out in Section 9 (Example consumers) of this Report, with key details in the table at the bottom of this page.

Illustrative impact of proposed changes:

Example Consumer	Value of Defined Benefits at Date of Calculation - Current Approach	Value of Defined Benefits at Date of Calculation – Proposed Approach	Change in Value increase/(decrease)	% Change in Value increase/(decrease)
1	£498,312	£485,539	(£12,773)	(2.6%)
3	£280,159	£262,562	(£17,597)	(6.3%)

All calculations are undertaken with a calculation date of 1 April 2022, i.e. using assumptions as at 31 March 2022. Calculations undertaken on a different date may result in different outcomes. The percentage impact on redress would differ depending on the value of the DC benefits.

Causes of change in value

Consumer 1: The decrease in value is primarily caused by the introduction of the IRP of 0.2% (2.1% out of the total 2.6% decrease). The introduction of the Black Scholes method for pension increases in payment explains the rest of the change.

Consumer 3: The decrease in value is caused partly by the introduction of the IRP of 0.2% (3.7% out of the total 6.3% decrease). There is a small impact from the change in the derivation of CPI, with the introduction of the Black Scholes method for pension increases in payment explaining the rest of the change.

It should be noted that as the pre-retirement discount rate is proposed to be updated to include reference to the updated CPI assumption (which includes the impact of the IRP), some of the above impact will be offset when the full proposed basis is considered (rather than the inflation assumptions in isolation as shown here).

Key Details of Example Consumers	Consumer 1	Consumer 3
Term to retirement	10	20
Pension Increases in deferment	CPI Max 5%	RPI Max 5%
Pension Increases in payment	Mix of CPI max 5% and CPI max 2.5%	RPI Max 2.5%

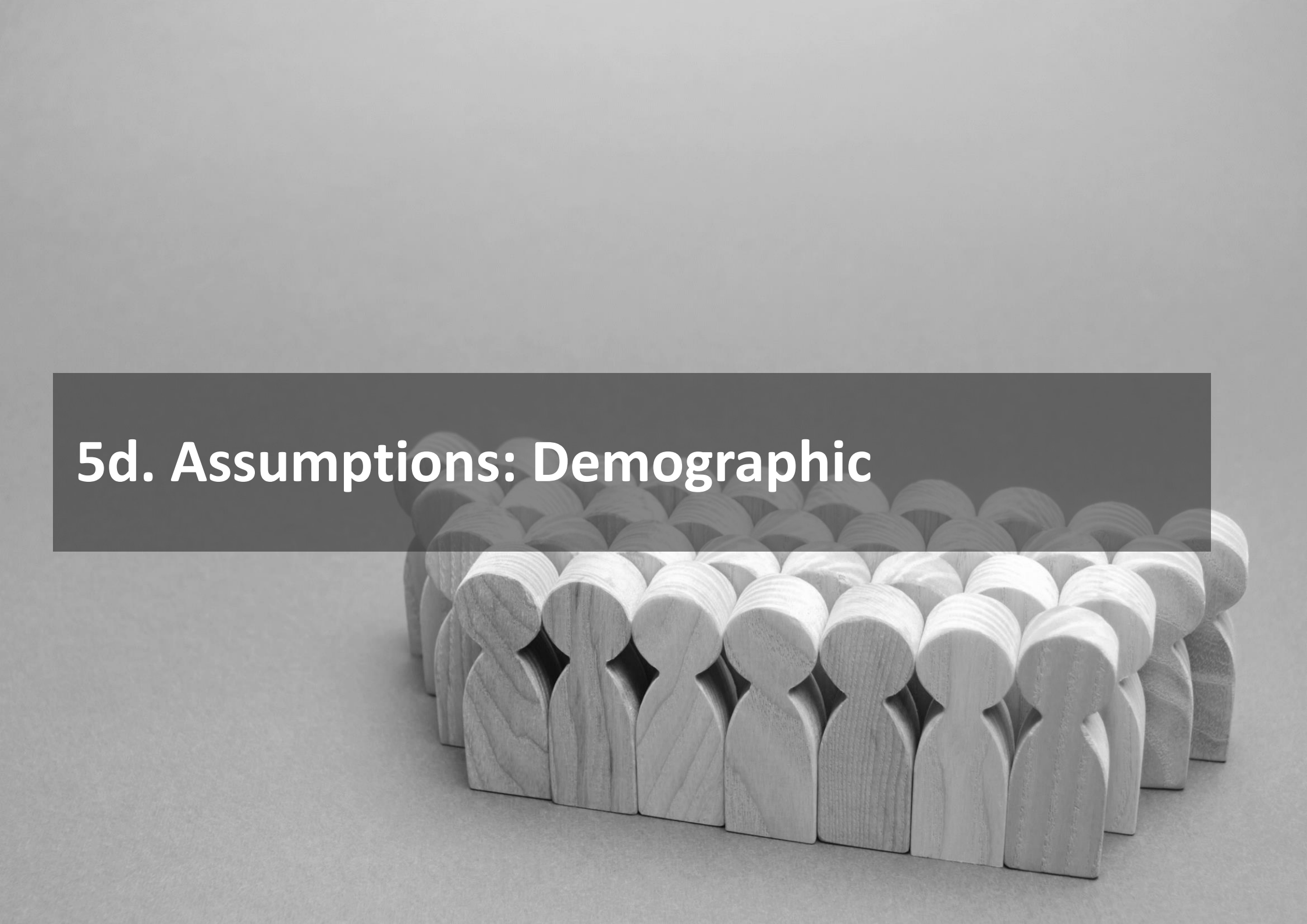
Assumptions – Inflation & Inflation Linked

Future review

Future Review

Given the changes to RPI proposed in 2030 (c.8 years' time), we consider this is an appropriate time for a review with an interim review undertaken in 4 years' time.

5d. Assumptions: Demographic



Assumptions – Demographic

Current approach

Assumptions are required about a consumer's future life expectancy in order to calculate the expected present value of the future DB pension payments the consumer would have received had they not received unsuitable advice to transfer.

Typically, the mortality assumption can be split into two parts:

- The "base table", which estimates current death rates; and
- An allowance for "future improvements in longevity", reflecting that over time death rates are expected to reduce.

Other demographic assumptions, such as spouse's age difference and proportion married, also influence the calculation of an expected present value of DB benefits.

The current approaches to deriving the main demographic assumptions as set out in the FG 17/9 Guidance are shown opposite.

Mortality

- Base Table: 100% of the PxA08 tables, published by the Institute & Faculty of Actuaries (IFoA) Continuous Mortality Investigation, assuming male and female mortality in equal parts.
- Future Improvements: Calculated using 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

Where known, the actual age of a consumer's spouse should be used, otherwise the spouse is considered to be the same age as the consumer.

Proportion married

It should be assumed that 85% will be married at retirement.

For Actual Loss cases, the actual marital status at date of crystallisation should be used, if known.

Assumptions – Demographic

Key considerations

We consider the following to be key issues to consider in respect of demographic assumptions:

Mortality assumptions

- Should the base table assumption be aligned to insurance industry specific tables or pension industry specific tables?
- Should the base table assumption be updated to reflect the most up to date base tables published?
- What is the most appropriate future improvements in longevity assumption?
- Should a gender-specific approach be used when setting the mortality assumptions?
- Should allowance be made for pre-retirement mortality?
- Should allowance be made for impaired lives using impaired life annuities?

Spouse/civil partner's age difference

- Should the consumer's actual spousal age difference be used, and should it be mandatory to request this information from the consumer? If this data isn't available from the consumer, what should be assumed?
- Where a spouse/civil partner is more than 10 years younger than the consumer, should a reduction to the spouse/civil partner's benefits be applied as is common in DB schemes?

Proportion married

- Does the latest market data support the current proportion married assumption?
- Should actual marital status be used, or should an assumption be used?
- Should the same proportion married assumption/ approach be used for both Prospective Loss and Actual Loss cases?

Key objectives for this set of assumptions include:

- Appropriate redress must, as far as possible, put the consumer into the position they would have been in if they had received compliant advice.
- To take account of factors such as recent and future changes to the pensions landscape, the availability of data, and actuarial standards and best practice to ensure the redress methodology and assumptions are as robust as possible over an extended period of time.
- To ensure consistency of approach between firms carrying out the calculation.
- To ensure clarity and minimise the scope for ambiguity in the application of the methodology and guidance, minimising the risk that the approach to calculating redress can be misinterpreted or manipulated.
- To enable those who undertake redress calculations or provide redress software to understand the rationale behind the methodology and assumptions and be able to apply it readily in practice.

Assumptions – Demographic

Mortality assumptions

Base table assumption

Under the current FG 17/9 Guidance, the base tables used are the PA08 tables, as published by the Continuous Mortality Investigation ("CMI"). These tables are based on mortality experience collected from UK insurance companies over 2007-2010.

An alternative approach would be to instead use base tables which are based on the mortality experience of defined benefit pension scheme members, as collected by the CMI in their Self Administered Pension Scheme ("SAPS") base tables. The most recently published SAPS base tables are the SAPS S3 tables.

As discussed in Sections 3 and 4 of this Report, we consider that the overall approach to calculating redress should continue to take the form of a lump sum payment based on the assumption that the consumer will then purchase an annuity at retirement to replicate the benefits they would have received from the DB scheme.

There is therefore a conflict between knowing that these consumers are former defined benefit pension scheme members (implying mortality experience consistent with the SAPS data) and the general approach of setting a basis for redress calculations in line with annuity pricing.

Annuity providers are likely to base their annuity pricing on bespoke in-house models reflecting their insurance book and in-house experience. However, we expect the CMI published 'insurance' ('PA') mortality tables are a reasonable proxy to this and representative of the industry as a whole.

Consideration could be given to the use of SAPS over the PA tables, citing they more accurately reflect the mortality of the impacted population, as former defined benefit scheme members. We would not disagree with this, however the aim when setting this assumption in the context of the redress methodology is to try to reflect annuity pricing not actual mortality rates.

The PA08 base tables were constructed based on mortality experience data over the period 2007-2010. A newer series of tables, the '16 Series' (or 'PA16') tables, were released in July 2020 and are based on data supplied by UK life insurance companies in respect of the mortality of pension annuitants covering four years, 2015-2018. The PA16 tables are both more recent and are based on a much larger dataset than that used for the current PA08 tables.

We also note that the Financial Reporting Council ("FRC") are consulting on updating the base table assumption used in the Actuarial Standard Technical Memorandum 1: Statutory Money Purchase Illustrations to be the PA16 tables[1]. The consultation was issued in February 2022 and responses were required by 6 May 2022.

The '16 Series' set of tables includes a specific table based on data relating to pension annuitants who purchased an annuity from a different insurer to the one that they were invested with before retirement (the "Ind_Ext" table). Arguably the population we are considering may align with this action so we have explicitly considered this table.

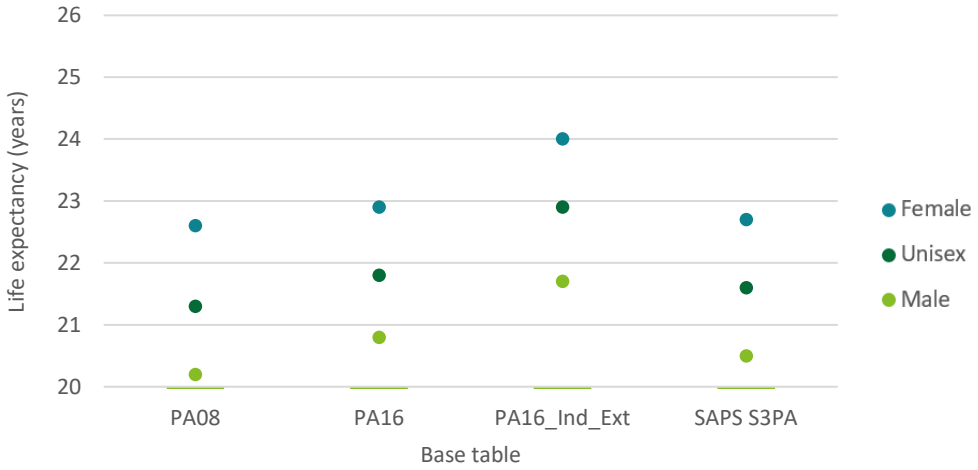
The CMI has released detail on the PA16_Ind_Ext tables to authorised users which shows that, as expected given it is a subsection, the size of the dataset used to construct the PA16_Ind_Ext tables is much smaller than the dataset used to construct the overall PA16 tables.

[1] https://www.frc.org.uk/getattachment/785aa14d-1df6-41b8-86ae-308e566a58f7/FRC-AS-TM1-Consultation-Paper-2022.pdf

Assumptions – Demographic

Mortality assumptions

The below chart compares the life expectancy for a 65 year old produced by each base table under consideration as at 1 April 2022 (no allowance has been made for any future improvements in longevity).

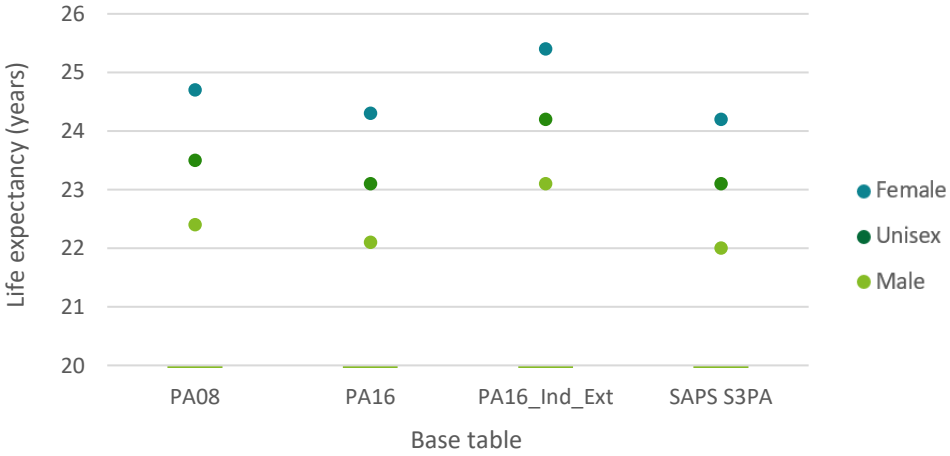


This chart shows that the life expectancies produced by the PA16 tables are slightly higher than those produced by the PA08 tables and are broadly in line with those produced by the SAPS S3PA tables. The PA16_Ind_Ext tables show a much higher life expectancy than the other tables. Caution needs to be applied to these comparisons though as the 'central date' of these tables is different. For example we would expect the PA16 tables to provide a higher life expectancy than the PA08 tables as it reflects improvements in longevity from c.2008 to c.2016.

The higher life expectancies observed using the PA16_Ind_Ext tables compared to the overall PA16 tables may be partially explained by some potential anti-selection present in the PA16_Ind_Ext sub-population. In particular, annuitants in this sub-population may be those who are taking advantage of increased pension freedoms (i.e. these annuitants are "shopping around" for the best annuity rates as they expect to live longer than average).

This review is focused on consumers who have been incorrectly advised to transfer/opt-out of a defined benefit pension arrangement. These consumers would not have otherwise been in a position to take advantage of increased pension freedoms, and there is no evidence they would be in better health than the overall PA16 table population. Therefore, in our view, the PA16_Ind_Ext tables are likely to misrepresent the life expectancies of the consumers covered by this redress methodology.

The chart below again compares the life expectancy for a 65 year old produced by each base table under consideration as at 1 April 2022, however allowance has now been made for future improvements in longevity (in line with CMI20 unisex projections with a 1.25% p.a. long term trend and default parameters).

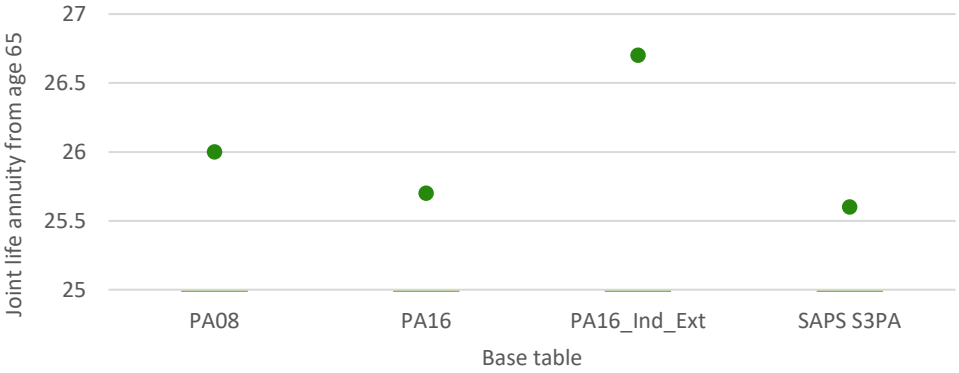


After allowing for future improvements in longevity, the life expectancies are higher under all tables, however the PA16 tables now produce life expectancies which are slightly lower than the PA08 tables and broadly in line with the SAPS S3PA tables. Once again the PA16_Ind_Ext tables produce life expectancies considerably higher than the other tables. We have included a similar analysis for individuals currently aged 45 in Appendix 4, which shows consistent findings across the various tables.

Assumptions – Demographic

Mortality assumptions

The below chart compares a joint life annuity payable from age 65 under each base table assumption, calculated as at 1 April 2022. The annuity is based on a 0% p.a. net rate (i.e. the discount rate is the same as future pension increases), no spouse/civil partner age difference, and future improvements of CMI20 unisex projections with a 1.25% p.a. long term trend and default parameters.



In line with the life expectancy analysis, adopting the PA16 tables would lead to a small reduction in the annuities used in redress calculations compared to adopting the PA08 tables. All else being equal, this would result in slightly lower redress. Comparing the annuity using the PA16 tables to the S3PA tables, there is minimal difference.

We propose that updating the base table assumption to the more recent PA16 tables would be in line with the FCA's objectives.

We understand that the CMI has been consulted by the FCA and they have confirmed that they will make the unisex PA16 tables publicly available (as they have with the unisex PA08 tables[1]) from the end of 2022 if required.

We have discounted the other base tables for the following reasons:

- **PA08 tables:** The data used to construct the PA16 tables is more recent and reflects actual mortality data since the PA08 tables were constructed. The PA16 tables are also based on a larger, more representative dataset.
- **SAPS S3 tables:** Whilst the consumers in this population will have previously been members of defined benefit pension schemes (and therefore there is an argument that the SAPS S3 tables better reflect the mortality experience of this population), we consider that it would be more appropriate to consider base tables constructed using insurance industry data, as the redress calculation methodology assumes that consumers being paid redress will purchase an annuity at retirement. We note that based on our analysis there would be little impact of using the SAPS S3 tables instead of the PA16 tables.
- **PA16_Ind_Ext tables:** Whilst the sub-population used to construct these tables may arguably be more relevant to consumers in this review, we consider that there is a selection effect present in this sub-population which does not reflect consumers covered by the redress methodology. Further, the dataset used to construct the PA16_Ind_Ext tables is much smaller than that used to construct the PA16 tables.

[1]www.actuaries.org.uk/learn-and-develop/continuous-mortality-investigation/other-cmi-outputs/unisex-rates-0

Assumptions – Demographic

Mortality assumptions

Future improvements assumption

Under the current FG 17/9 Guidance, future improvements are calculated using male and female annual 'core' 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. The CMI projections model remains an industry standard approach, and our view is that there is no reason to move away from this for future improvements. We also consider there to be no justification to move away from the 'core' model. We note that from the CMI 2020 projections onwards, the 'core' model places no reliance on 2020 and 2021 mortality due to the impact of COVID-19 on mortality data. We consider this to be a reasonable approach.

The long term trend of 1.25% is widely adopted as a 'best estimate' in the pension industry, particularly for corporate pensions accounting.

Similar to the base table assumption, we expect that some insurers will use their own in-house projections (or adjustments to the standard CMI model) when setting pricing, although we do not expect this to make a material difference to the ultimate annuity rates derived.

Overall, we consider maintaining the current approach of using the 'minus 2 years' published male and female annual CMI Mortality Projections Models with a long term trend of 1.25% would be in line with the FCA's objectives.

Annuity providers are likely to be using a higher long term trend to allow for prudence and reserving requirements. We consider it reasonable to maintain this level of future improvements and use the post retirement discount rate annuity pricing adjustment to reflect any necessary prudence in the pricing levels.

Gender specific pricing

In formulating the mortality assumptions, the base table and future improvement assumptions could be selected to be gender-specific. This would reflect the underlying cost of the benefit, based on the consumer's specific circumstances.

Alternatively, gender neutral assumptions could be adopted. Gender neutral pricing is required in the current annuity market, and so this approach better reflects the realistic price of purchasing an annuity.

Whilst we acknowledge that a gender-specific approach better reflects the underlying cost of the benefit rather than the price of the annuity, we consider that a gender neutral approach appropriately reflects the current annuity market.

Assumptions – Demographic

Mortality assumptions

Pre-retirement mortality

We consider making allowance for pre-retirement mortality, with a corresponding allowance for the death before retirement benefits provided by the DB scheme, would be in line with the FCA's objectives. We understand an allowance is already made by a number of Redress Providers.

Using the same assumption as used for the post retirement mortality is considered a reasonable and practical approach. The proposed PA16 tables provide mortality data for consumers from age 20 upwards and therefore are suitable for this purpose.

Impaired lives

Under the current FG 17/9 Guidance, no allowance is made for impaired lives. Whilst impaired lives would be able to obtain differently priced annuities, this would require relevant information about the consumer's health to be collected. This may be difficult for Redress Providers to achieve in practice.

An assumption would also be required about whether the consumer's health status remains unchanged until the time the consumer comes to purchase an annuity. This may be reasonable for someone close to retirement age but less appropriate the younger the member.

We consider that this is a policy decision for the FCA. We consider that the consultation should cover the potential approach to including allowance for impaired life status in redress calculations for Prospective Loss cases and the practical challenges associated with it.

Assumptions – Demographic

Spouse/civil partner's age difference

Part of the benefit that a consumer would have had in the DB scheme is in respect of the pension payable to their spouse/civil partner upon their death. To calculate the expected value of this benefit, allowance needs to be made in the redress calculation for the age of the spouse/civil partner. This is typically expressed as the difference between the consumer's age and the spouse/civil partner's age. When calculating redress amounts, the age of the consumer's spouse/civil partner will either be known or unknown.

Actual spouse/civil partner age difference

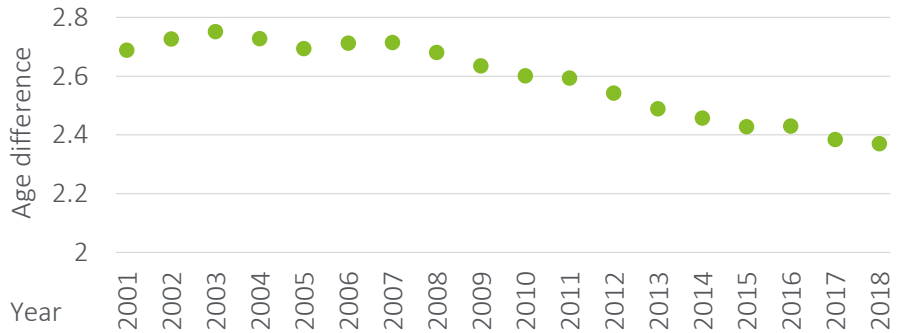
Where the actual ages of the consumer and spouse/civil partner are known, this data should be used as it will provide a more accurate calculation of the redress entitlement. This data should be straightforward to obtain and therefore we consider that it is reasonable for this to be a mandatory data request. We note that consumers cannot be mandated to provide such data, therefore Redress Providers should make consumers aware of the assumption they will use if the information is not provided.

Assumption for spouse/civil partner age difference

Where it is not possible for the spouse/civil partner's age to be obtained then an assumption will be required. Under the existing FG 17/9 Guidance, if the actual age of a consumer's spouse/civil partner is not known, then the spouse/civil partner is considered to be the same age as the consumer. We note that this assumption was updated following the 2017 Consultation (the previous assumption was an age difference of 3 years).

In the 2017 Consultation, it was commented that female spouses are typically three years younger, but spouses in same-sex relationships tend to be the same age. Anecdotal evidence from pension schemes more recently has shown that the three year gap for wives of male members remains appropriate, however husbands of female members tend to be closer in age than 3 years (somewhere between 1-2 years older). There is no substantive data to analyse age differences for same-sex relationships in pension schemes.

We have carried out analysis on the most recently published ONS data which shows a wider spread of age differences, with the majority between 0 and 3 year age difference. The chart below illustrates the average age difference in marriages of opposite-sex couples in England and Wales, based on ONS data[1].



This shows that the average age difference has been decreasing towards two years in recent years. This analysis reiterates that the age difference in opposite-sex couple is converging, and as such we do not consider that it would be appropriate to return to the historic assumption of a 3 year age difference. However, an age difference of 2 years may be considered to most accurately reflect the data.

One of the reasons set out in the 2017 Consultation for moving to a nil age gap was that it promotes equal treatment for consumers irrespective of their sexual orientation and is consistent with the gender neutral approach to mortality. There is no compelling new market data since the 2017 Consultation for the FCA to move away from this approach.

Based on this, we consider that the existing approach of assuming that the consumer and their spouse/dependant are the same age continues to meet the FCA's objectives.

[1] https://www.nomisweb.co.uk/datasets/lemacpsaew

Assumptions – Demographic

Spouse/civil partner's age difference

Calculations where a spouse/civil partner is more than 10 years younger than the consumer

Some DB schemes will have a provision in their rules to reduce the pension payable to a spouse/civil partner if that spouse/civil partner is more than 10 years younger than the original member. There may be some circumstances where it is not known whether the DB scheme would apply a deduction (indeed, not all DB schemes do and for some schemes it is at the discretion of the trustees).

We note that this situation will be rare and so making an allowance to reflect the possibility of the age difference being more than 10 years would not be expected to impact many consumers. If applicable, it will decrease the value placed on the value of the DB benefits and therefore reduce redress. The extent of the impact on redress will depend on the deduction applied.

There is a risk that different Redress Providers are taking different approaches. We recommend providing clear guidance for this scenario to reduce the risk of inconsistency of approach.

Incorporating an allowance for a deduction due to a 10 year younger spouse/civil partner may require software providers to build this into their existing software, albeit this should be a relatively straightforward adjustment.

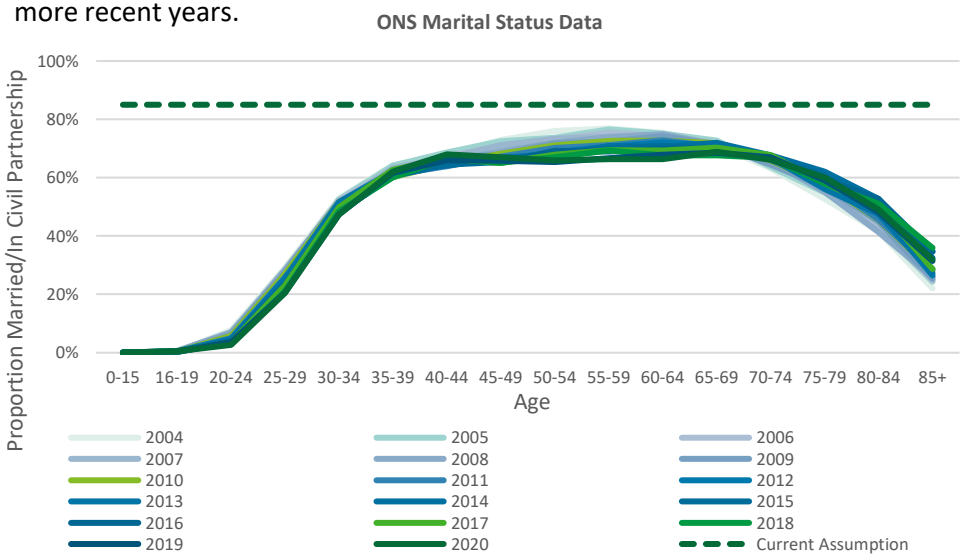
Where the reduction in benefits is known, we consider that this should be allowed for within redress calculations (i.e. this is the process of valuing the actual DB scheme benefits).

Where it is not known whether a reduction in pension would have applied in the DB scheme to a spouse/civil partner who is more than 10 years younger than the original member, we propose that no allowance should be made for any reduction.

Proportion married/in civil partnership

Whilst most DB pension schemes provide a spouse/civil partner's pension upon the death of the member, not all consumers are married/in a civil partnership. An assumption therefore needs to be made in redress calculations for the proportion of consumers that are married/in a civil partnership at retirement age. It is also common for DB schemes to offer a dependant's pension to members' dependants/ children upon the member's death (provided the child is financially dependent and typically is payable only for a limited time). The proportion married/in a civil partnership assumption therefore also needs to account for this.

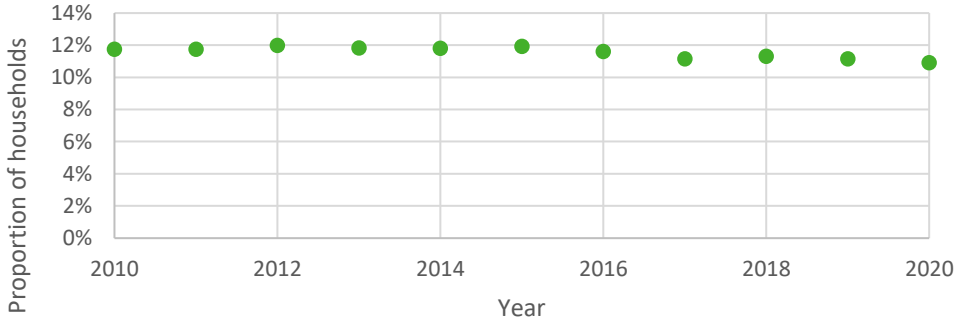
We have carried out analysis based on marital status data for England and Wales from the ONS[1]. The chart below shows the proportion of the population that are married (defined as both opposite sex and same sex marriages) or in a civil partnership, together with the existing assumption used in the current FG 17/9 Guidance of 85% for Prospective Loss cases. The darker lines are the more recent years.



This analysis suggests that the average proportion married/ in a civil partnership at typical retirement ages (i.e. 55-70) is on average around 65% - 70% and whilst relatively consistent at these ages, it has, in general, been declining in recent years.

This supports that there is not a compelling rationale to move away from a single fixed percentage assumption for different retirement ages. However it does support consideration of a reduction in the percentage figure used.

We have also carried out analysis on data from the ONS which looks at the proportion of unmarried/non-civil partnered households which have a dependent child in the house[2]. This is shown in the chart below.



This analysis shows that there are c.11% of households where there is a dependent child in an unmarried/non-civil partnered house. Whilst this is useful, the exact definition of dependant will vary for each DB scheme based on the definition in each scheme's rules. We would expect these children to fall within the definition of dependant for most schemes, albeit child's pensions will typically only be payable for limited number of years. It is also worth noting that there may be other dependants not covered by this data that would benefit from a dependant's pension (i.e. those who do not live in one household, and those who are not a child (but are still financially dependent)).

[1] https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/bulletins/populationestimatesbymaritalstatusandlivingarrangements/2020
[2] https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/families/bulletins/familiesandhouseholds/2020

Assumptions – Demographic

Proportion married/in civil partnership

Based on this analysis, if the use of a single assumption is maintained, in general we consider that a proportion married/in civil partnership assumption in the range of 75% - 80% is appropriate.

However, for Prospective Loss cases, consideration could be given to the current marital/civil partnership status of the consumer. It is the status at the point of retirement that is important not the current status, and this would therefore require further assumptions about changes in marital/civil partnership status between current age and retirement.

This is the approach which was adopted in the original SIB guidance for the Pension Review where a table of proportion married was used based on the consumer's term to retirement and their current marital status. We have considered producing a similar table for use now, using ONS data and certain assumptions about future changes in status (e.g. marriages, divorces). Such analysis has limitations due to the data which is available and presumptions about future consumer behaviour.

We note in the 2017 Consultation, it was recognised that collecting individual data, which may or may not still be relevant by retirement age, would add complexity to the calculations. The move to a single assumption (of 85%) regardless of actual marital status was therefore considered appropriate by the FCA as part of the conclusion of the 2017 Consultation.

Given that current marital/civil partnership status does provide an indication of expected status at retirement (particularly for those closer to retirement) we consider it is appropriate to revisit this assumption and for the FCA to consider re-introducing the use of a table of factors to better meet the FCA's objectives. We have therefore set out a proposed table of factors on the right.

Adopting this table (rather than a single assumption) would better reflect the specific consumer circumstances and reduce the potential 'cliff edge' for consumers who are close to retirement and change from a Prospective Loss to Actual Loss case (where actual marital/civil partnership status is adopted in the calculation).

We note that the approach will materially reduce redress for non-married/civil partnered consumers (particularly those who are close to retirement) compared to the current approach (i.e. 85% assumed married/in civil partnership).

	Current marital status at Date of Calculation	
Term to retirement	**Married/In civil partnership**	**Not Married/Not in civil partnership**
0	100%	0%
5	95%	10%
10	90%	20%
15	85%	30%
20	80%	40%
25	75%	45%
30	70%	50%
35	70%	55%
40	70%	55%

In line with the gender neutral approach taken for other assumptions, we do not propose different assumptions for males and females. These rates should be applied at the consumer's assumed retirement age or date of death for death in deferment calculations (and interpolated for other terms and rounded to the nearest 1%). No adjustment should be applied for mortality of the spouse/partner before application.

Assumptions – Demographic

Overall Conclusions

Overall, we propose updating the mortality assumptions to reflect the latest released tables and strengthening the wording used for the spouse's age difference.

Current Approach

Mortality

Base Table - 100% of the PxA08 tables, published by the Institute & Faculty of Actuaries (IFoA) Continuous Mortality Investigation, assuming male and female mortality in equal parts.

Future Improvements – Calculated using 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

Where known, the actual age of a consumer's spouse should be used, otherwise the spouse is considered to be the same age as the consumer.

Proposed Approach

Mortality

Base Table - 100% of the PxA16 tables, published by the Institute & Faculty of Actuaries (IFoA) Continuous Mortality Investigation, assuming male and female mortality in equal parts.

Future Improvements – Calculated using 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/Civil Partner's Age Difference

The actual age of a consumer's spouse/civil partner should be requested and used where possible, otherwise the spouse/civil partner should be considered to be the same age as the consumer.

Assumptions – Demographic

Overall Conclusions

Overall, we propose updating the proportion married assumptions to reflect the latest data and consumer information for Prospective Loss cases.

Current Approach

Proportion married

It should be assumed that 85% of consumers will be married at retirement.

For actual loss cases, the actual marital status at date of crystallisation should be used, if known.

Proposed Approach

For Prospective Loss cases, the table below should be used for the proportion married/in a civil partnership based on the actual marital/partnership status of the consumer at Date of Calculation.

Term to retirement	Married/In civil partnership	Not Married/Not in civil partnership
0	100%	0%
5	95%	10%
10	90%	20%
15	85%	30%
20	80%	40%
25	75%	45%
30	70%	50%
35	70%	55%
40	70%	55%

Rates should be interpolated for other terms and rounded to the nearest 1%. No adjustment should be applied for mortality of the spouse/partner before application.

For Actual Loss cases, the actual marital/partnership status at Date of Calculation should be used, if known.

Assumptions – Demographic

Impact on value of DB benefits

The table below shows the impact on the value placed on the DB scheme benefits of the changes proposed for the demographic assumptions in isolation for a selection of example consumers. All other assumptions/methodologies have been maintained in line with the current FG 17/9 Guidance. Details on the example consumers we have considered are set out in Section 9 (Example consumers) of this Report, with key details in the table at the bottom of this page.

Illustrative impact of proposed changes:

Example Consumer	Value of Defined Benefits at Date of Calculation - Current Approach	Value of Defined Benefits at Date of Calculation – Proposed Approach	Change in Value *increase/(decrease)*	% Change in Value *increase/(decrease)*
3	£280,159	£259,647	(£20,512)	(7.3%)
7	£496,024	£493,454	(£2,570)	(0.5%)

All calculations are undertaken with a calculation date of 1 April 2022, i.e. using assumptions as at 31 March 2022. Calculations undertaken on a different date may result in different outcomes. The percentage impact on redress would differ depending on the value of the DC benefits.

Causes of change in value

Consumer 3: The decrease in value is caused by the change in mortality assumption (0.4% out of the total 7.3% decrease) and the proportion married/in civil partnership change (6.9%).

Consumer 7: The decrease in value is caused by the change in mortality assumption (1.3%) partially offset by the proportion married/in civil partnership change (0.8% increase).

Key Details of Example Consumer	Consumer 3	Consumer 7
Gender	Male	Female
Retirement Age	60	65
Current Age	40	55
Marital/Civil Partnership Status	Single	Married

Assumptions – Demographic

Future review

Future review

We propose that a review is undertaken if any of the following triggers are met:

- The assumptions have not been reviewed for 8 years; or
- The CMI announces an updated set of base tables, based on more recent data than the PA16 tables; or
- The CMI announces significant changes in the methodology used to construct base tables or their mortality projection models.

5e. Methodology: Charges

Methodology – Charges

Current approach

Consumers will typically be incurring charges in their DC arrangement in the period prior to retirement. This could include product/fund charges and regular adviser charges.

The current FG 17/9 Guidance sets out the following approaches to allowing for charges. The FCA provided further clarification on the approach to allow for charges in a Statement on 1 September 2021.

Personal Pension Charges:

The personal pension charges, where known, should be deducted from the pre-retirement discount rate up to a maximum of 0.75% per year.

Where the charges are not known or are structured differently, the calculation should result in a figure which is no greater than a deduction of 0.75% per year from the pre-retirement discount rate for personal pension charges.

This deduction is based on product charges only and any regular adviser charges on top of this should be deducted separately.

For actual loss cases, if any adviser fees have been incurred when the pension at retirement [entered] into a decumulation product, these should also be deducted from the proceeds of the personal pension arrangement.

FCA Statement 1 September 2021:

Redress should enable consumers to cover the cost of ongoing product charges and regular adviser charges up to normal retirement age, both on the transferred pension and the amount of redress.

For prospective loss cases:

- The redress amount should allow for personal pension charges, where known, up to a maximum of 0.75% per year and allow for regular adviser charges on top of this.
- The pre-retirement discount rate should be netted down to allow for ongoing product charges and regular adviser charges in percentage terms up to normal retirement age.
- Regular adviser charges should be assumed to continue in full, at the current level.
- Where firms use any other method to take account of future product and ongoing adviser charges, e.g. for non-percentage-based charges, they should satisfy themselves that the result achieves the same intent.

For actual loss cases, the personal pension value used for the redress calculation should take account of any adviser charges that were incurred when the pension moved into decumulation at retirement.

Firms should allow for ongoing adviser charges in redress calculations. In line with Principle 6 and the requirement to handle complaints fairly under DISP, firms should not withdraw or change the cost of ongoing advice services without good reason. Where another firm is giving ongoing advice, firms should allow for ongoing adviser charges. This is to compensate the consumer for charges that they would not have incurred if they had not been advised to leave their DB scheme.

Methodology – Charges

Key considerations

We consider the following to be key issues to consider in respect of determining an appropriate approach to allow for charges:

- How should charges be allowed for?
- How should the pre-retirement discount rate be reduced to allow for charges?
- Should the allowance for fund/product charges be capped (and if so at what level), or should actual charges be allowed for where known?
- Should the allowance for adviser charges be capped (and if so at what level), or should actual adviser charges be allowed for where known?
- How should non percentage charges be allowed for?
- Should charges be allowed for in Actual Loss cases? Should allowance be made for post retirement charges where a consumer has not annuitised (e.g. on-going advice where a consumer is in drawdown)?

Some decisions in respect of the approach to adopt for charges will be subjective and careful consideration will be needed to reduce the risk of either over or under compensating consumers.

The revised guidance will need to clearly state which charges should be allowed for, how these charges should be allowed for and the level of charges for inclusion to remove the potential for ambiguity.

Key objectives for this section include:

- Appropriate redress must, as far as possible, put the consumer into the position they would have been in if they had received compliant advice.
- To take account of factors such as recent and future changes to the pensions landscape, the availability of data, and actuarial standards and best practice to ensure the redress methodology and assumptions are as robust as possible over an extended period of time.
- To ensure consistency of approach between firms carrying out the calculation.
- To ensure clarity and minimise the scope for ambiguity in the application of the methodology and guidance, minimising the risk that the approach to calculating redress can be misinterpreted or manipulated.
- To ensure key elements of the redress calculation to be transparent and explainable to consumers.

Methodology – Charges

The approach to allow for charges

Consumers will typically incur charges on their DC funds. The most common types of charges are product/ fund charges and regular adviser charges. These are typically charged as a percentage of the fund value.

Any charges incurred by the consumer between date of transfer and Date of Calculation will already be implicitly included in the DC fund value at Date of Calculation. However, where consumers are yet to reach retirement (i.e. Prospective Loss cases) they will continue to incur charges up to retirement. Allowance for these future charges (in the period from Date of Calculation to retirement) that consumers will incur needs to be included in redress calculations. Allowing for charges results in an increase in the redress calculated.

Under the current FG 17/9 Guidance, charges are allowed for via a 'deduction' to the pre-retirement discount rate. This approach effectively assumes that the redress received will be invested by the consumer in a way that is exposed to consistent charges to those in their DC arrangement. This approach is consistent with the FCA's stated aim that: *redress should enable consumers to cover the cost of ongoing product charges and regular adviser charges up to retirement, both on the transferred pension and the amount of redress*. If the redress payment is made into the consumer's DC arrangement this approach would be considered to most accurately put the consumer back in the position they would have been in if they had received compliant advice.

An alternative approach is for a deduction for future charges to be made in relation to the DC value used in the redress calculation. This approach would provide redress to effectively cover the future charges to be incurred on the consumer's DC fund, but would not provide redress to cover any future charges that would be incurred on the redress amount.

Where the redress is paid as a lump sum (rather than into the DC fund) it could be argued that this better reflects the reality of the position.

However, the consumer would need to invest the redress amount in order to achieve a return in line with the pre-retirement discount rate assumption. To do this it is reasonable to assume that the consumer would incur charges and thus that future charges on the redress amount should be allowed for.

We therefore consider that the approach in the current FG 17/9 Guidance of an allowance for charges being made via a 'deduction' to the pre-retirement discount rate remains appropriate for the FCA's objectives.

We understand that there is a risk of inconsistent market practices being adopted in respect of the approach to apply the 'deduction' to the pre-retirement discount rate for charges. The use of the word 'deduction' creates potential for ambiguity.

The FCA provided clarity on this in the 1 September 2021 statement, stating that the appropriate approach to allow for charges should be to 'net down' the pre-retirement discount rate (rather than simply deducting the charges from the pre-retirement discount rate).

We are in agreement that the allowance for charges should be made by 'netting down' the pre-retirement discount rate.
This would be undertaken as follows:

- Pre-retirement discount rate (unadjusted for charges): i% p.a.
- Charges: c% p.a.

Pre-retirement discount rate (adjusted for charges): [(1+i%) * (1-c%)] – 1

Methodology – Charges

The level of product/ fund charges to allow for

Under the current FG 17/9 Guidance:

- Product / fund charges: Allows for actual charges up to a cap of 0.75% p.a.
- Adviser charges: Allows for actual charges with no cap.

Under the current FG 17/9 Guidance, there is a risk of inconsistency in the way that product/fund and adviser charges are allowed for, given that one is capped and the other isn't. We propose that a consistent approach adopted for all charges allowed for in the redress calculation would be better aligned to the FCA's objectives.

Fund/ Product charges

Under the current FG 17/9 Guidance, the actual personal pension charges are used up to a maximum of 0.75% p.a. Where the charges are unknown, the default assumption to adopt is 0.75% p.a.

The rationale for the current approach as set out in the 2017 Consultation response is the view that the majority of consumers are already in, or able to access, products with charges of 0.75% or less. This is set at the level of the charge cap for default arrangements for occupational pension schemes.

Since then, time has passed and wider analysis has been undertaken by the FCA on charges in DC schemes. In our experience, typically individuals who transfer out of a DB scheme are more likely to transfer to a non-workplace pension arrangement rather than a workplace pension arrangement.

FCA Feedback Statement FS 19/5[1] Annex 3 provides analysis of the charges observed in the UK market for non-workplace pensions. This analysis evidences that charges are typically higher (in percentage terms) the longer ago the transfer was and the smaller the size of the consumer's DC fund. For certain categories of consumers, the analysis evidenced average charges greater than 0.75% p.a. Details of the analysis is set out in Appendix 5.

A limitation of the current approach is in respect of consumers who are incurring charges in excess of 0.75% p.a. If they remain invested in their current products/ funds then the redress amount payable under this approach would not sufficiently compensate the consumer.

This could be a particular challenge for consumers invested in products/ funds with charges in excess of 0.75% p.a. where there are exit penalties or barriers to transferring to a lower cost arrangement.

An alternate approach would be to base the fund/product charges on actual charges with no cap. Feedback to the 2017 Consultation indicated that in reality charges can range from 0.25% to 2%. This is broadly consistent with the FCA's findings in FS 19/5.

Allowing for actual charges would accurately reflect the costs currently being incurred by the consumer and would lead to an increase in redress compared to the current approach. However, if consumers subsequently moved to a lower cost fund then they would be over-compensated.

[1]www.fca.org.uk/publications/feedback-statements/fs19-5-effective-competition-non-workplace-pensions

Methodology – Charges

The level of product/ fund charges to allow for

We consider that current product/ fund charges being assumed to continue in full at the level currently being incurred by the consumer would be in line with the FCA's objectives. This is consistent with the FCA's 1 September 2021 Statement on the approach to adopt for ongoing adviser charges.

We consider that revising the redress methodology to reflect actual product/ fund charges, removing the 0.75% p.a. cap would better meet the FCA's objectives. This will provide consistency with the approach to adviser charges in the current FG 17/9 Guidance and reflect that fact that the charges being incurred by certain consumers are greater than 0.75% p.a.

However, the FCA may wish to consider whether an alternative approach (including a potentially higher cap) should be applied to avoid redress providers being required to compensate for excessively high charges and to reflect the 'duty to mitigate' (i.e. the consumer's duty to take steps to minimise their loss). The FCA may wish to seek views in the consultation on this.

Where the charges are unknown we propose that the default assumption of 0.75% p.a. should be maintained which is in line with the charge cap for default arrangements for occupational pension schemes.

Methodology – Charges

The level of adviser charges to allow for

Adviser charges

Where consumers are receiving on-going advice in the DC arrangement pre retirement, it is considered appropriate to allow for the on-going adviser charges in the redress calculation. Otherwise, the consumer would be under compensated.

The FCA provided clarity in the 1 September 2021 statement that regular adviser charges should be assumed to continue in full, at the current level.

In our experience, ongoing advice charges can vary significantly based on the firm and the service provided. We do not consider it appropriate to include a cap on adviser charges, due to the variability of the costs being incurred by consumers.

We therefore consider that the current approach of allowing for actual adviser charges (assuming they continue in full, at the current level without a cap) is in line with the FCA's objectives.

It is acknowledged that consumers could incur additional adviser charges at retirement when the consumer makes a decision on how to access their benefits (i.e. annuity purchase or flexible access).

The redress methodology is based on replicating the benefits in the DB scheme (i.e. annuity purchase). Therefore we do not consider that an allowance for future at retirement advice charges should be included in the redress methodology as an explicit allowance.

Consideration is required in respect of those consumers who are currently not receiving ongoing advice (and thus not currently incurring on-going adviser charges).

Under the current FG 17/9 Guidance, those currently receiving ongoing advice will receive sufficient redress to enable them to continue receiving ongoing advice. Whereas, those not currently receiving on-going advice will not be provided with redress sufficient to enable them to receive advice in the future.

We consider that there are two options for consideration:

- Maintain the existing approach, which results in those not currently receiving ongoing advice receiving insufficient redress to enable them to take advice in the future; or
- Where it is known that a consumer is not receiving ongoing advice (or if it is unknown) then adopting a default assumed allowance for ongoing advice which would enable all consumers receiving redress to be able to access some form of ongoing advice in the future.

The existing approach most accurately reflects a consumer's current position. However, the alternate approach would enable all consumers to receive ongoing advice going forwards. We consider that the approach to adopt is a policy decision for the FCA. These two options (including the level of the default assumption) could be included in the consultation.

When communicating a redress offer to consumers, it is important that any assumptions that have been made are clearly explained. The actual charges paid by the consumer (or acknowledged that this is unknown), and the corresponding amount of the charge compensated for should be explicitly stated and explained.

Methodology – Charges

Non-percentage charges

Non-percentage charges

The FCA's Statement on 1 September 2021 clarified that where firms use any other method to take account of future product and ongoing adviser charges, e.g. for non-percentage-based charges, they should satisfy themselves that the result achieves the same intent.

Where some of the charges are a fixed monetary amount and not a percentage of fund, a different approach would be required rather than a deduction to the pre-retirement discount rate.

We understand from the FCA that there are inconsistent practices being adopted by Redress Providers to allow for non-percentage charges. We consider that the redress methodology should be prescriptive in respect of the approach to reduce the risk of ambiguity.

We consider it appropriate to require Redress Providers to calculate the net present value of these fixed monetary charges (in the period from Date of Calculation to assumed retirement age) based on the pre-retirement discount rate prior to any charges adjustment (with allowance for pre-retirement mortality). This amount should then be added to the redress amount.

We consider that this approach would be the most consistent with the approach adopted for charges which are a percentage of fund. This approach would be considered to most accurately put the consumer back in the position they would have been in if they had received compliant advice.

Example 1

- Consumer aged 60 at Date of Calculation
- Assumed retirement age (i.e. earliest age can access benefits unreduced): 65
- Term to retirement: 5 years
- Charges. £100 p.a. increasing at 3% p.a. (charges taken from fund annually – £103 charge assumed to apply at end of the first year)
- Pre-retirement discount rate (unadjusted for charges): 3.5% p.a.

Age	61	62	63	64	65
Charge taken from fund	103.00	106.09	109.27	112.55	115.93
Charge discounted back to Date of Calculation	99.52	99.04	98.56	98.08	97.61

Total net present value of charges from the table above: £492.80 (rounding to the nearest 1p is undertaken at the end of the calculation, not rounding the intermediate steps).

Whilst not shown here, allowance should also be made for pre-retirement mortality in determining the final net present value to be added to the redress amount.

Methodology – Charges

Charges post retirement

Charges post retirement

Under the current FG 17/9 Guidance, there is no allowance for charges incurred post retirement.

Where a consumer purchases an annuity, this is considered an appropriate assumption. However, an increasing number of consumers are accessing their benefits flexibly (i.e. income drawdown) and thus consideration is required as to whether charges 'post retirement' should be allowed for.

For Actual Loss cases the current approach means that no allowance is made for future charges (post Date of Calculation) regardless of how the consumer has accessed their benefits. There will be consumers who have entered drawdown who will be incurring ongoing adviser charges and their funds subject to ongoing product/ fund charges.

The objective of the redress methodology is to put the consumer back into the position they would have been, and is based around the notion of providing sufficient funds to purchase an annuity at retirement equivalent to the benefits in the DB scheme.

Therefore we do not consider it is aligned to the FCA's objectives to allow for future charges to be incurred 'post retirement' where a consumer chooses to maintain drawdown rather than purchase an annuity on receipt of redress. This is a consumer decision.

When communicating a redress offer to consumers (in particular in Actual Loss cases), it should be clearly communicated what has been assumed in respect of the future charges relative to the consumer's circumstances.

Methodology – Charges

Overall Conclusions

Overall we propose amendments to the existing approach for setting the charges methodology to better meet the objectives set out earlier.

Current Approach

Personal Pension Charges: The personal pension charges, where known, should be deducted from the pre-retirement discount rate up to a maximum of 0.75% per year.

Where the charges are not known or are structured differently, the calculation should result in a figure which is no greater than a deduction of 0.75% per year from the pre-retirement discount rate for personal pension charges.

Non percentage charges: Where firms use any other method to take account of future product and ongoing adviser charges, e.g. for non-percentage-based charges, they should satisfy themselves that the result achieves the same intent.

Adviser Charges: Regular adviser charges should be assumed to continue in full, at the current level. The regular adviser charges should be deducted from the pre-retirement discount rate.

For Consultation

Personal Pension Charges: The FCA may wish to consider whether an alternative approach to that currently used (including a potentially higher cap) should be applied to avoid redress providers being required to compensate for excessively high charges and to reflect the 'duty to mitigate' (i.e. the consumer's duty to take steps to minimise their loss).

Adviser Charges: Where a consumer is not currently receiving ongoing advice a decision is required as to whether an allowance for ongoing advice in the future should be allowed for (and if so the assumed level of allowance).

Proposed Approach

Overall approach: Allowance for charges should be made by 'netting down' the pre-retirement discount rate. This would be undertaken as follows:

- Pre-retirement discount rate (unadjusted for charges): i% p.a.
- Charges: c% p.a.

Pre-retirement discount rate (adjusted for charges): [(1+i%) * (1-c%)] – 1

Personal Pension Charges: The personal pension charges, where known, should be 'netted off' the pre-retirement discount rate.

Where the charges are not known, personal pension charges should be assumed to be 0.75% p.a. per year.

Non percentage charges: Where non percentage charges apply, the net present value of these fixed monetary charges (in the period from Date of Calculation to assumed retirement age) should be calculated based on the pre-retirement discount rate prior to any charges adjustment (with allowance for pre-retirement mortality). This amount should then be added to the redress amount.

Where firms use any other method to take account of future product and ongoing adviser charges, they should satisfy themselves that the result achieves the same intent.

Adviser Charges: Regular adviser charges should be assumed to continue in full, at the current level. The regular adviser charges should be 'netted off' from the pre-retirement discount rate.

Methodology – Charges

Impact on value of DB benefits

The table below shows the impact of the changes proposed for the product/ fund charges assumption in isolation for a selection of example consumers. All other assumptions/methodologies have been maintained in line with the current FG 17/9 Guidance. Details on the example consumers we have considered are set out in Section 9 (Example consumers) of this Report, with key details in the table at the bottom of this page.

Illustrative impact of proposed changes:

Example Consumer	Value of Defined Benefits at Date of Calculation - Current Approach	Value of Defined Benefits at Date of Calculation – Proposed Approach	Change in Value increase/(decrease)	% Change in Value increase/(decrease)
1	£498,312	£512,107	£13,795	2.8%
3	£280,159	£294,568	£14,409	5.1%
5	£598,256	£598,256	Nil	Nil

All calculations are undertaken with a calculation date of 1 April 2022, i.e. using assumptions as at 31 March 2022. Calculations undertaken on a different date may result in different outcomes. The percentage impact on redress would differ depending on the value of the DC benefits.

Causes of change in value

For consumers 1 and 3 the amount of charges allowed for is no longer capped at 0.75% p.a. and therefore the value placed on the Defined Benefits is increased. There is no impact to consumer 5 as their charges are already below 0.75% p.a.

Key Details of Example Consumers	Consumer 1	Consumer 3	Consumer 5
Term to retirement	10	20	5
Personal Pension Charges (p.a.)	1%	1%	0.5%

Methodology – Charges

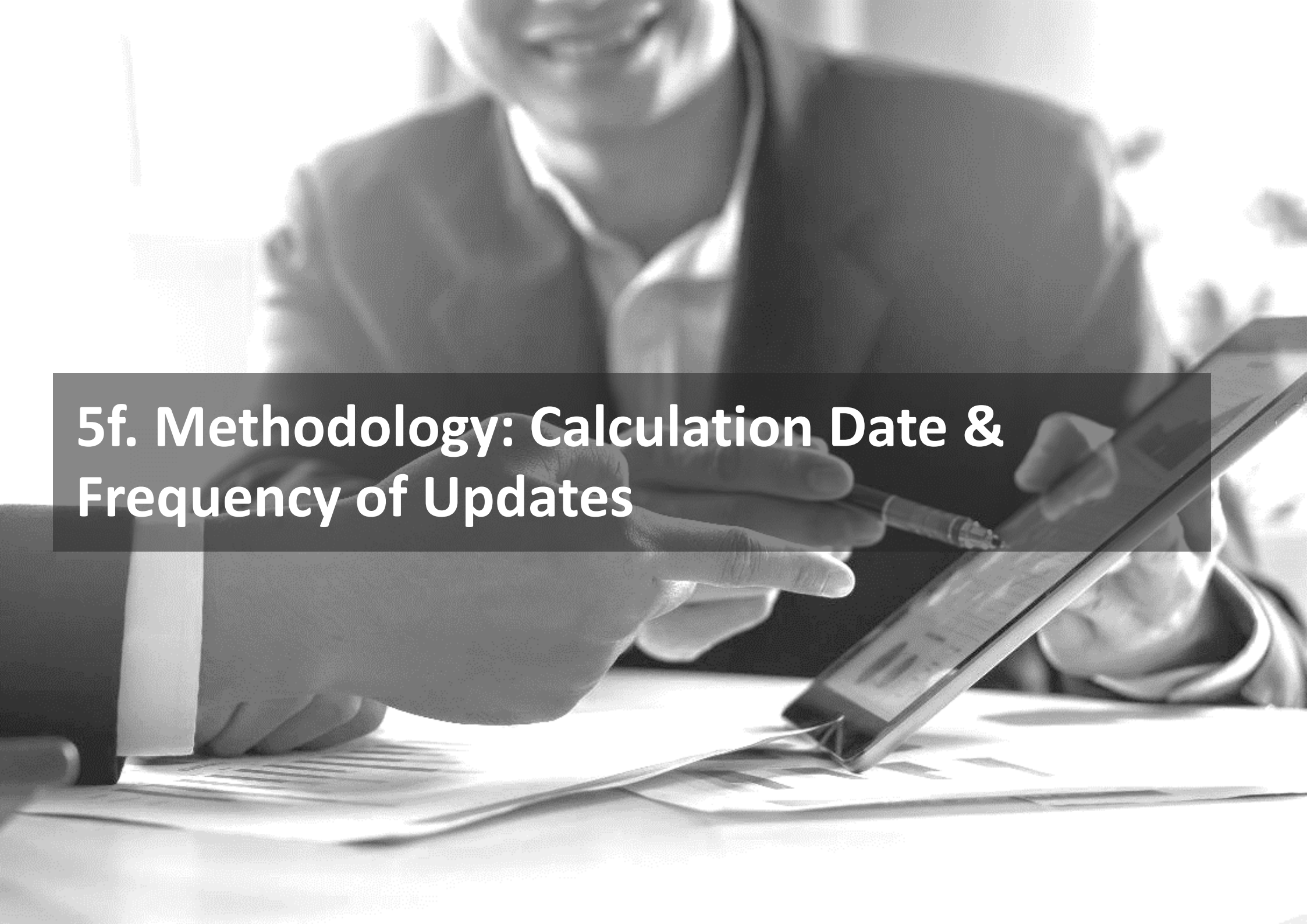
Future review

Future review

Given it is proposed that actual charges are adopted where these are known, this is unlikely to require regular review. The default assumption where charges are not known (e.g. 0.75% p.a. for product/ fund charges) should be reviewed periodically in light of further market data.

In particular, we propose that a review is undertaken if:

- there are any changes to the charge cap for default arrangements for qualifying schemes; or
- any further analysis is undertaken by the FCA which evidences changes to charging patterns in non-workplace pensions.



5f. Methodology: Calculation Date & Frequency of Updates

Methodology – Calculation Date & Frequency of Updates

Current approach

The effective date at which a redress calculation is undertaken (and the market conditions on which the underlying calculation assumptions are based) can have a material impact on the level of redress calculated.

How frequently the market conditions underlying assumptions should be updated needs to balance a desire for accuracy in volatile markets versus practicality and not creating spurious accuracy, noting that calculations will take a period of time to issue to consumers.

The current FG 17/9 Guidance sets out the following in regards to calculation dates and the frequency of updates to assumptions used in the calculation of redress.

- Assumptions used in the calculation of redress should be updated quarterly.
- Redress calculations must be based on the new assumptions from the first business day of each new quarter, using publicly available data based on the final business day of the quarter just ended.
- Calculations made under this guidance will remain valid for three months from date of issue to the consumer, irrespective of quarterly changes to the assumptions.

There are a number of areas in respect of the practicalities of calculating and paying redress where we consider greater clarity could be provided. We consider that these should be addressed in the consultation.

Methodology – Calculation Date & Frequency of Updates

Key considerations

We consider the following to be key issues to consider in respect of determining an appropriate approach to calculation dates and frequency of assumptions updates:

- How frequently should the assumptions be updated to reflect changes in market conditions? Does quarterly remain the most appropriate approach?
- At what date should the redress calculation be undertaken?
- Should redress be increased from Date of Calculation to date of settlement (and if so, at what rate)?
- What approach should be adopted where there is no readily available DC fund value?
- How long should a redress calculation remain valid for (from Date of Calculation/ date of issue to the consumer)?

Some decisions in respect of the approach to adopt will be subjective and careful consideration will be needed to balance the competing objectives of accuracy and practicality.

Key objectives for this section include:

- Appropriate redress must, as far as possible, put the consumer into the position they would have been in if they had received compliant advice.
- To take account of factors such as recent and future changes to the pensions landscape, the availability of data, and actuarial standards and best practice to ensure the redress methodology and assumptions are as robust as possible over an extended period of time.
- To ensure consistency of approach between firms carrying out the calculation.
- To ensure clarity and minimise the scope for ambiguity in the application of the methodology and guidance, minimising the risk that the approach to calculating redress can be misinterpreted or manipulated.
- To allow calculations to be completed efficiently to avoid delays and excessive costs in resolving complaints.
- To enable those who undertake redress calculations or provide redress software to understand the rationale behind the methodology and assumptions and be able to apply it readily in practice.
- To ensure key elements of the redress calculation to be transparent and explainable to consumers.

Methodology – Calculation Date & Frequency of Updates

Frequency of updates

Under the current FG 17/9 Guidance, the assumptions to be adopted for redress calculations are required to be updated quarterly, with assumptions derived based on market conditions on the final business day of the previous quarter.

Determining an appropriate frequency of updates needs to balance a desire for accuracy in volatile markets against the practicalities of undertaking (and issuing) redress calculations.

There are a range of possible update frequencies which deserve consideration. In line with views put forward by respondents to the 2017 Consultation, we consider the possible update periods for consideration to be daily, monthly, quarterly (current approach) and annually.

We are aware that different redress calculators use different approaches to update for market conditions (as per the current quarterly updates). Some may have automatic links to market data, some may require an installation of a new data file or some may require manual updating of market data/ assumptions.

We have set out below specific considerations for each of the possible update frequencies.

Daily updates

This would involve redress calculations being undertaken based on market data as at the Date of Calculation.

We understand that the Bank of England aim to publish data by midday of the following business day, although there are occasions when this isn't achieved. For other data sources such as Bloomberg and Markit, published data may be subject to a 1.5 working day time-lag delay, which may be increased around public holidays. There is a necessity for the data adopted in the methodology to be from publicly available sources (such as the Bank of England).

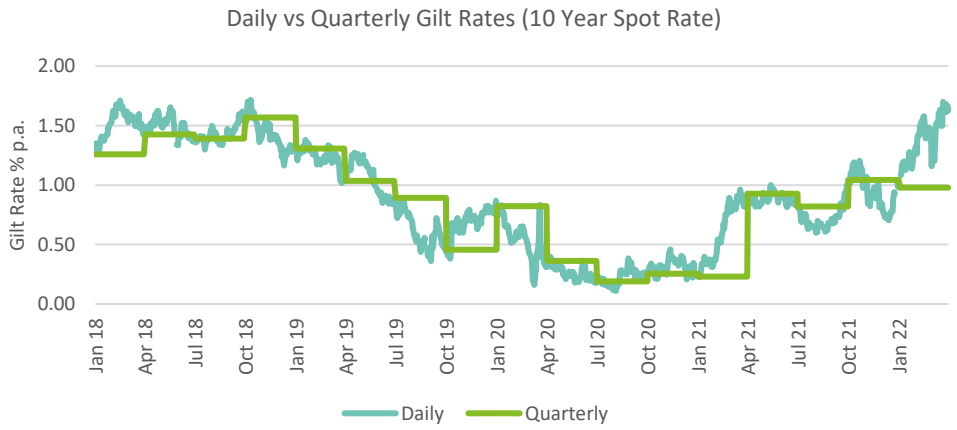
Due to this, we consider that daily updates would not be feasible (even excluding the practical challenges such an approach would provide).

It should also be noted that the current redress approach is based on a wide ranging number of 'general' assumptions. Therefore requiring calculations to be undertaken based on daily updated market data could be considered to be attempting to introduce spurious accuracy.

Quarterly updates (the current approach)

With market conditions continuously changing, the more frequent the update, the more 'accurate' the redress calculation at the Date of Calculation. Markets have been volatile over recent years and we have seen periods where gilt yields have changed by up to 0.8% over a quarter. This could have a material impact on the redress amount calculated.

The adoption of quarterly assumptions updates seeks to strike a balance between the increased accuracy of more frequent assumptions updates and the practicalities of calculating and issuing redress calculations to consumers.



Methodology – Calculation Date & Frequency of Updates

Frequency of updates

Monthly updates

Updating the assumptions on a monthly basis would result in more 'accurate' redress calculations than the use of quarterly assumptions.

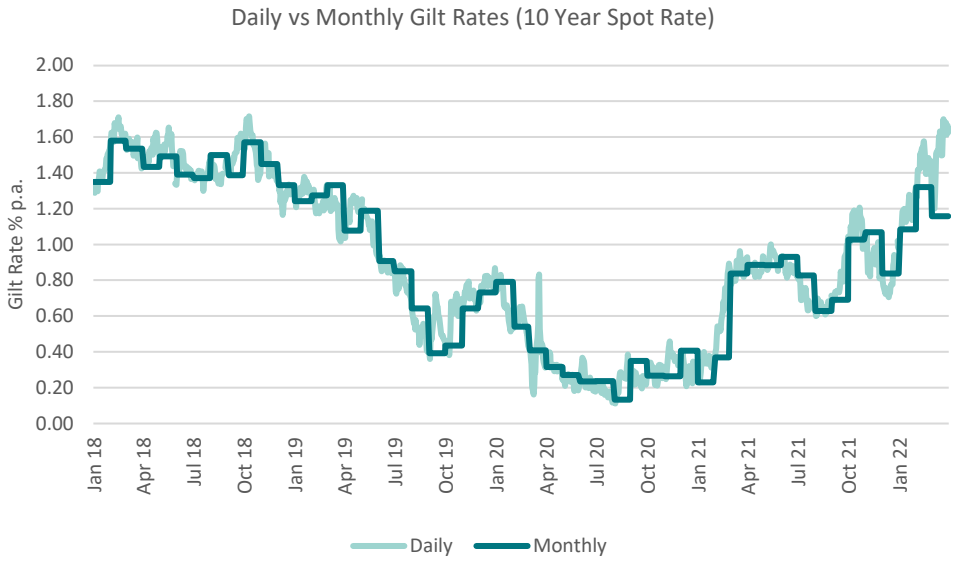
However, we consider that requiring assumption updates more frequently than quarterly would begin to create a number of practical challenges for software providers, calculators of redress and firms responsible for issuing redress offers to consumers.

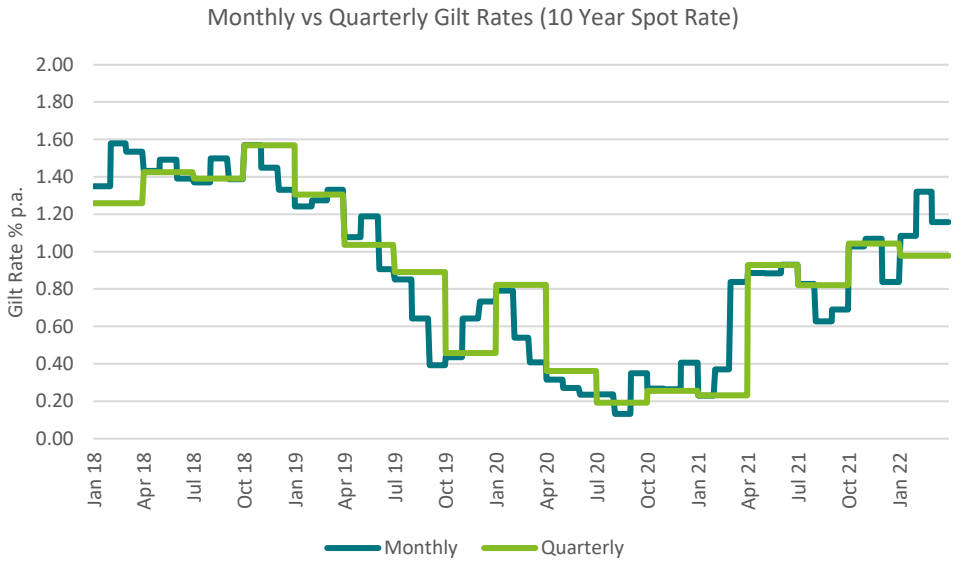
Updating assumptions more frequently than the current approach (quarterly) would require more time, effort and expense by software providers (i.e. having to update software more frequently). The extent of the additional work will depend on the method used for assumption updates. Requiring more frequent updates would likely be feasible for software offering automatic market feeds, but will become increasingly challenging for those requiring manual inputs.

The time period calculations remain valid for

Under the current FG 17/9 Guidance, redress offers remain valid for three months from date of issue. We understand that Redress Providers are interpreting the current guidance as requiring the offer to be issued before the underlying assumptions change (i.e. before moving into a new quarter).

We consider it an important aspect of the approach, to require firms to issue redress calculations within the period that the assumptions underlying the calculation relate to. An alternate approach would be to allow firms a fixed period of time from the Date of Calculation (e.g. three months) to issue redress offers irrespective of changes in the underlying assumptions.





Methodology – Calculation Date & Frequency of Updates

Frequency of updates

However, if a fixed period of time was adopted this would create the potential for Redress Providers to 'game' the approach by undertaking a redress calculation in multiple periods and selecting the calculation which provides the lower redress.

Depending on the specific circumstances of each case, the time from the start of a redress calculation to the issue of a redress offer to a consumer can be several weeks. If the approach of redress calculations having to be issued within the period that the assumptions relate to is maintained, then updating assumptions monthly would increase the likelihood of redress calculations being out of date before they were issued and thus require recalculation.

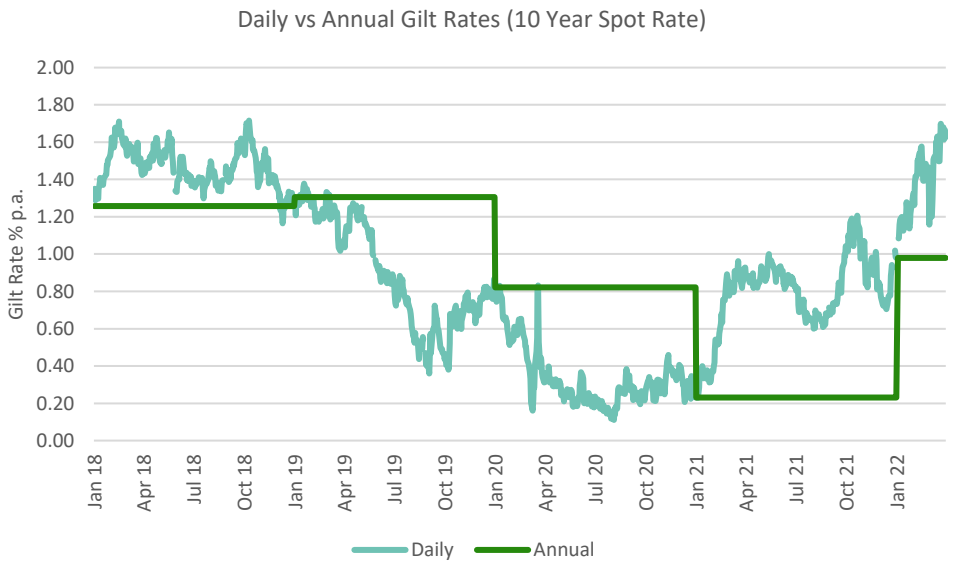
If Redress Providers were to front end load their calculations into the first two weeks of the month, this would mean that no calculations would be being undertaken c50% of the time (i.e. the last two weeks of a month).

In this scenario, the increased accuracy of updating the assumptions monthly would in our view be outweighed by the practical challenges.

We do acknowledge that updating assumptions monthly provides a more accurate approach compared to updating assumptions quarterly given the potential volatility in market conditions/ assumptions over a quarter. If the FCA concluded that there was no requirement for redress calculations to be issued during the period the assumptions related to (acknowledging the potential for 'gaming' set out above), in this scenario we would support the move to monthly assumptions updates.

Annual updates

Market movements over annual periods can be very significant (as shown in the graphs below). We consider that this volatility is too great to justify extending the update period beyond quarterly, particularly as the industry is already successfully operating with quarterly updates. Therefore we do not consider that there is justification for moving to annual updates.



Overall, we consider that the current approach of updating the assumptions quarterly remains appropriate for the FCA's objectives and provides an appropriate balance between accuracy and practicality. However, monthly updates could also be appropriate within a suitable framework.

Methodology – Calculation Date & Frequency of Updates

Calculation Date

We recommend that the Date of Calculation to be adopted is explicitly confirmed in any updated guidance to provide consistency across the market. We understand from the FCA that there are a range of approaches currently being adopted by Redress Providers.

We believe a key principle should be to value the DB and DC benefits at the same date.

We consider that there are two main options for consideration, as set out below. Whilst there are some disadvantages of these two approaches, we consider that they provide consistency with the valuation of the DB and DC benefits.

First Business Day of the Quarter

The current FG 17/9 Guidance states that "Redress calculations must be based on the new assumptions from the first business day of each new quarter" therefore aligning the Date of Calculation to assumptions date is relatively simple to implement and understand.

Provided that the DC value was available at the first business day of the quarter, this approach would align the valuation of both the DB and DC elements.

We understand from the FCA that this is the most commonly adopted approach by Redress Providers undertaking redress calculations (i.e. with a Date of Calculation of the first business day of the quarter adopted for all calculations carried out during the quarter).

Current Date/ Latest available DC fund value date

An alternative approach would be to use the 'current' actual date or the date of the latest DC fund valuation, providing this is within the same quarter.

We understand from the FCA that there are Redress Providers currently adopting this approach. We are also aware that the Financial Ombudsman has in some cases stated that a calculation should be carried out on the date of its final decision.

Under this scenario, the DC fund value would be based on actual market conditions at the current date. However, whilst the DB benefits are being calculated as at the current date, using this approach implicitly assumes markets for valuing the DB benefits are stable between quarter end dates as the assumptions are not updated from the first business day of the quarter. In practice this is unlikely to be the case and therefore this approach does not fully align with the valuing of the DB and DC benefits at the same date on the same market conditions.

Therefore we consider that the redress methodology should confirm that redress calculations should be undertaken with a Date of Calculation of the first business day of the quarter for calculations undertaken within the quarter.

For practical reasons, there will be a period of time between the Date of Calculation (first business day of the quarter), the date that the redress offer is issued to the consumer and again until the consumer accepts the offer and the redress payment is made. Consideration is required in respect of the extent to which an allowance for interest between Date of Calculation and settlement date should be made. This is discussed on the next page.

Methodology – Calculation Date & Frequency of Updates

Interest on redress

Under the current FG 17/9 Guidance, redress calculations are valid for three months from the date they are issued to the consumer. The current approach may therefore mean that the consumer is accepting an offer that is up to six months 'out of date' depending on how quickly the provider issues the offer (i.e. calculation date of first day of quarter, issued on the last day of the quarter and then a three month validity period).

As a result, we consider it appropriate to give consideration to increasing the redress amount with interest from Date of Calculation to date of settlement.

We understand from the FCA that the approach being adopted across the market to the application of interest is mixed. We understand that approaches being adopted range from making no allowance for interest, to applying 8% p.a. simple interest.

Under the Pension Review, redress at the calculation date was expressed as a percentage of the consumer's DC fund. Redress at settlement date was then that percentage of the consumer's DC fund at settlement date. This approach effectively assumed that the redress was invested in the DC fund from Date of Calculation (i.e. the approach compensates for the missing fund growth for the period between Date of Calculation and settlement).

Under the current redress approach and tax regime, it is accepted that redress will often be paid as a lump sum to the consumer outside of their DC fund. Therefore an alternative approach (based on the same principle as the Pension Review approach) would be for Prospective Loss cases to increase the redress amount from Date of Calculation to date of settlement in line with the pre-retirement discount rate (with an adjustment for charges).

For Prospective Loss cases

We consider that the redress should be increased from Date of Calculation to date of settlement in line with the pre-retirement discount rate used in the underlying redress calculation (with an adjustment for charges). This is to reflect that the redress methodology is assuming the redress would have been invested to achieve a return in line with the pre-retirement discount rate over the period from Date of Calculation to date of settlement.

For Actual Loss cases

We consider that redress should be increased in line with the post-retirement discount rate (with no adjustment for annuity pricing (i.e. the 0.6% mentioned in Section 5b (Assumptions: Post-retirement Discount Rate) of this Report nor PCLS)). This is to reflect that the redress methodology is assuming the redress would have been invested to achieve a return in line with the post-retirement discount rate over the period from Date of Calculation to date of settlement.

Methodology – Calculation Date & Frequency of Updates

Availability of DC fund values

We are aware that in certain (limited) circumstances, up-to-date DC values at the Date of Calculation will not be readily available to Redress Providers. This could either be because the investments are in illiquid/ unquoted assets or because the DC provider is unable to provide them.

In general, where funds are invested in a liquid asset, we would expect every effort to be made to obtain an up-to-date value, and situations where this is not possible should be rare.

Where there is no valuation available for DC benefits at the calculation date, liquid and illiquid/ unquoted assets should be considered separately:

Liquid assets

If the DC fund is made up of liquid, market related assets and there is a price of the underlying fund(s) available, we consider that a notional value of the DC fund at the Date of Calculation should be calculated by looking at the movement of the fund using the underlying fund price (and allowing for known charges).

We consider that this approach would most accurately provide an appropriate market related DC fund value at the Date of Calculation.

Illiquid/ Unquoted assets

If the DC fund is made up of illiquid / unquoted assets, then there are limited options to obtain a market value at the Date of Calculation.

The starting point would be the latest available value. By definition there is no liquid market for illiquid assets. As such, it is considered reasonable to assume that the value of these assets will not have changed materially (in real terms) between the historical valuation date and the current date.

This could be the case unless there is clear evidence that the value has moved materially, for example, a pronounced fall in the property market.

The FRC is consulting on proposed revisions to TM1: Statutory Money Purchase Illustrations. For unquoted assets the FRC is proposing that the value of the asset should be the same as the latest available valuation and that the asset value should remain unchanged in real terms in future (i.e. in effect that the asset increases with CPI indefinitely). The FRC consider this approach to be a pragmatic solution given the complexity of typical unquoted assets.

For illiquid/ unquoted assets where a valuation is not available at the Date of Calculation, we propose that the value adopted should be the latest available valuation increased in line with CPI inflation from the latest available valuation date to the calculation date, unless there is clear evidence to that the value has otherwise moved materially.

Methodology – Calculation Date & Frequency of Updates

Timescales

Under the current FG 17/9 Guidance, redress calculations are valid for three months from the date they are issued to the consumer. We understand that Redress Providers are interpreting the guidance as requiring the offer to be issued before the underlying assumptions change (i.e. before moving into a new quarter) and that a recalculation is needed if the redress offer has not been issued before the end of the quarter.

The current approach may therefore mean that the consumer is accepting an offer that is up to 6 months 'out of date' depending on how quickly the provider issues the offer (i.e. calculation date of first day of quarter, issued on the last day of the quarter and then a three month validity period).

An alternative approach could be for redress calculations to be valid for a set period from the Date of Calculation (e.g. three months). Consumers would then be in a consistent position in respect of market movements impacting the accuracy of their calculation.

However, changing the approach for the redress offer to be valid for three months from the Date of Calculation will reduce the time for the consumer to consider and accept the offer. There will naturally be differences between the calculation date and issue date across Redress Providers leading to different consumers having different time periods to accept, which may be considered unfair. In this scenario further guidance would be required as to the minimum amount a time a consumer must have to consider the offer.

Furthermore it would place additional pressure on providers to issue their redress offers faster.

We propose retaining the current approach of calculations being valid for three months from date of issue, with the redress offers needing to be issued to consumers in the quarter that they are calculated. We consider a period of three months to be reasonable as a balance between stability and practicality.

The current approach does to some extent lend itself to requiring the bulk of work being done at the start of the quarter to provide sufficient time to complete the calculation and having it checked and issued before the end of the quarter.

In practice, the provider can use the time before the quarterly assumptions are released to carry out the data gathering exercise and set up the calculation which is likely to be the most time consuming part of the calculation process.

We consider that the three month period over which the assumptions remain unchanged provides a sufficient amount of time to calculate redress, review and issue to the consumer. We consider that this is a pragmatic solution.

Other considerations

One issue that was raised as a concern in the 2017 Consultation is the risk of consumers (or their representatives) requesting updated calculations in more favourable conditions.

We understand that Redress Providers typically stick to the original offer of redress unless a consumer does not come back at all (for example due to a change of address) or has a genuine reason for rejecting the offer. The only time a recalculation would normally be required is where there is an error in the original redress calculation.

The principle here is that the consumer should not be in a position to pick and choose when the redress is calculated to obtain a higher offer and on the other hand the Redress Provider should also not be in a position to pick and choose when the redress is calculated so it makes a lower offer.

If a recalculation is required where an offer is considered to have expired then the communication to the consumer should have a condition to say that any recalculation may result in a lower offer of redress.

Methodology – Calculation Date & Frequency of Updates

Overall Conclusions

Overall we propose that the redress methodology is updated to provide greater clarity on the approach that should be adopted to a number of practical aspects of redress calculations.

Current approach

Assumption Updates: Assumptions used in the calculation of redress should be updated quarterly.

Calculation Date: Redress calculations must be based on the new assumptions from the first business day of each new quarter, using publicly available data based on the final business day of the quarter just ended.

Timescales: Calculations made under this guidance will remain valid for three months from date of issue to the consumer, irrespective of quarterly changes to the assumptions.

Proposed approach

Assumption Updates: Assumptions used in the calculation of redress should be updated quarterly.

Calculation Date: The Date of Calculation should be the first business day of the quarter (for calculations undertaken within the quarter).

Redress calculations must be based on the new assumptions from the first business day of each new quarter, using publicly available data based on the final business day of the quarter just ended.

Timescales: Calculations will remain valid for three months from date of issue to the consumer, irrespective of quarterly changes to the assumptions.

Interest on redress: Interest should be applied to the redress amount calculated for the period from Date of Calculation to date of settlement.

- For Prospective Loss cases, interest should be applied in line with the pre-retirement discount rate assumption (with an adjustment for charges)
- For Actual Loss cases: interest should be applied in line with the post-retirement discount rate assumption (with no adjustment for annuity pricing nor PCLS)

DC value: Where an up-to-date DC value is not available at the Date of Calculation:

- Market related assets: where there is a price of the underlying fund(s) available: A notional value of the DC fund at the Date of Calculation should be determined based on the movement of the fund using the underlying fund price (and allowing for known charges).
- Illiquid/ unquoted assets: The value adopted should be the latest available valuation increased in line with actual CPI inflation from the latest available valuation date to the Date of Calculation unless there is clear evidence to that the value has otherwise moved materially.

5g. Assumptions & Methodology: Other

Assumptions & Methodology – Other

Current approach

There are a number of other assumptions and methodologies which underlie the approach used for calculating redress. This section covers the areas set out below.

The current FG 17/9 Guidance sets out the approach for the following areas:

Retirement Age: The earliest age at which the customer could have retired from the DB Pension Scheme without both:

- Requiring the consent of the employer; and
- Suffering a reduction in benefits

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

Earnings Growth: *No explicit wording in the current FG 17/9 Guidance*

Enhanced Transfer Values: Where a cash enhancement was paid in addition to the transfer value, the cash enhancement should be rolled up from the date of payment to the calculation date using 50% of the return on the FTSE100 Total Return Index. This should be net of personal pension charges for each year, as determined previously, and the figure added to the value of the consumer's personal pension policy.

Pension Protection Fund (PPF): A respondent should consider how far they should take into account any adjustment to the benefits which the consumer would have been eligible for under the DB scheme including the scheme entering the Pension Protection Fund.

Separate Lump Sums: The PCLS adjustment may be modified to reflect where the PCLS was additional to pension income in the original scheme.

Tax: The redress lump sum should be adjusted to take account of the consumer's individual tax position.

Interest on payments: *No explicit wording in the current* FG 17/9 *Guidance*

Assumptions & Methodology – Other

Key considerations

We consider the following to be key issues to consider in respect of setting the assumptions covered:

- What should the assumed retirement age be for Prospective Loss cases? Guidance on retirement ages should be clear to avoid inconsistencies in approach.
- What is an appropriate assumption for the level of future salary / earnings growth (required for Section 148 orders and opt-out/ non-joiner cases)?
- What allowance should be made for where the original DB scheme has entered the PPF or is in the PPF Assessment Period?
- What should be the treatment of any Enhanced Transfer Values (ETVs) paid to the consumer directly as an incentive to transfer out of their original DB scheme? Should the pre-retirement discount rate, or actual known return on personal pension to date be used in respect of ETVs 'roll-up'?
- What allowance should be made where a separate lump sum is provided by the DB scheme? Should the standard PCLS adjustment within the post-retirement discount rate apply?
- What allowance should be made where a consumer had an AVC fund or DC section within the DB scheme and where the DB scheme rules allowed the PCLS to be taken from those sources before commuting DB pension? Should the standard PCLS adjustment within the post-retirement discount rate apply?
- What level of interest should apply to past payments?
- How much guidance should be given on the implications of tax and means-tested benefits on the payment of redress within the redress methodology?

Key objectives for this section include:

- Appropriate redress must, as far as possible, put the consumer into the position they would have been in if they had received compliant advice.
- To ensure consistency of approach between firms carrying out the calculation.
- To ensure clarity and minimise the scope for ambiguity in the application of the methodology and guidance, minimising the risk that the approach to calculating redress can be misinterpreted or manipulated.
- To ensure key elements of the redress calculation are transparent and explainable to consumers.
- To enable those who undertake redress calculations or provide redress software to understand the rationale behind the methodology and assumptions and be able to apply it readily in practice.

Assumptions & Methodology – Other

Retirement Age for Prospective Loss cases

Assumed retirement age

The current approach assumes retirement age is the earliest age at which the consumer could have retired from the DB scheme without both:

- Requiring the consent of the employer; and
- Suffering a reduction in benefits.

We consider that this approach remains appropriate for the FCA's objectives (subject to the comments below). In certain DB schemes, trustee consent will be required for early retirement. Consistent with the current approach, we consider that it should be assumed that the trustees would have provided this consent.

Approach where multiple benefit tranches with different retirement ages

Where a consumer has benefits payable from different ages within the same scheme in respect of a single period of membership (e.g. a tranche of pension with a normal retirement age of 60 and another tranche of pension with a normal retirement age of 65), the current approach of reflecting 'the most favourable option' is considered reasonable.

However, there are some ambiguities with this approach that should be considered to minimise the risk of misinterpretation and inconsistencies arising. The current approach may require multiple calculations to be undertaken to determine the 'most favourable'.

An alternative approach would be to assume the retirement age as the age where the consumer can take the 'majority' of their benefits unreduced. This would remove the need for multiple calculations, however it would require a definition of 'majority' to be set out in the redress methodology. Defining 'majority' would need to be done robustly enough to leave no room for ambiguity and misinterpretation by Redress Providers. Due to the practical challenges associated with this, we do not favour this approach.

For consumers who have benefit tranches which are payable unreduced from both age 60 and 65, early or late retirement factors will be required to adjust the relevant tranches to the assumed retirement age. Ideally the relevant factors from the original DB scheme would be used.

Even if the factors from the original DB scheme were available, they would only be 'correct' at the current time and so may not be appropriate for future retirements as necessary for Prospective Loss cases. Therefore it may be necessary to prescribe factors to use in these calculations. The prescription of factors would support both consistency and simplicity in approach for Redress Providers.

Further considerations are necessary for Actual Loss cases (which are explicitly covered in Section 6 (Actual Loss) of this Report), therefore the comments here apply primarily to Prospective Loss cases.

Overall, we therefore support the existing approach of using the earliest age at which the consumer could have taken benefits unreduced from the DB scheme, reflecting the most favourable option for the consumer. Commentary on the prescription and application of 'default' early and late retirement factors is contained in Section 6 (Actual Loss) of this Report. These factors should be applied equally for Prospective Loss cases where relevant.

The approach to adopt where the consumer has already reached the retirement age of the DB scheme, but has not yet accessed benefits in the DC arrangement also needs to be considered. This is unlikely to be a common scenario, however we consider that the redress methodology should be clear on this to improve consistency in these cases.

We consider that the approach adopted needs to be consistent with the approach taken to determining 'retirement age' for Actual Loss cases.

Assumptions & Methodology – Other

Future Salary/Earnings growth

The current FG 17/9 Guidance does not prescribe an assumption for future salary/earnings growth which may be needed for elements such as future Section 148 (revaluation of earnings) orders increases and/or for opt-out/non-joiner cases.

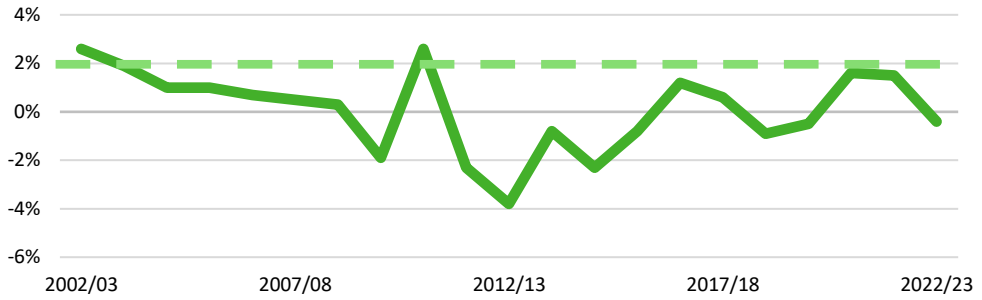
Previous SIB guidance[1] set out a rate of RPI + 2% p.a. for future salary increases and we understand this assumption continues to be used by Redress Providers where this assumption is required. We do not consider this rate to be appropriate for current calculations as it results in an assumption that is too high in light of current level of earnings growth. The graph on the top right shows the difference between S148 Orders and RPI inflation for the last 20 years (i.e. S148 Orders minus RPI inflation), supporting that the approach of RPI + 2% p.a. is too high. The second graph shows the difference with CPI inflation.

Current future earnings growth assumptions will be heavily distorted by the ongoing impact of the COVID-19 pandemic and the current high inflationary environment. Indeed the latest projections by the Office for Budget Responsibility[2] show negative real earnings growth is expected over the next few years.

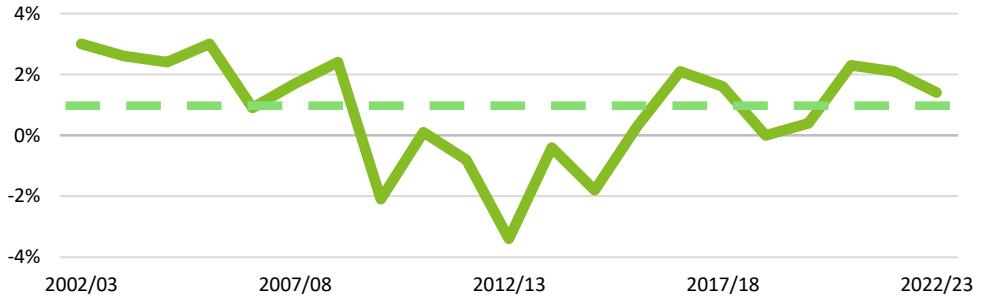
We are aware of a wide range of future salary growth assumptions being adopted in the market for corporate accounting purposes. Assumptions are linked to both CPI and RPI. There are a variety of positive and negative real salary growth assumptions adopted which reflect the individual sponsors' views of their industry and their employees.

As set out in the Section 5c (Assumptions: Inflation & Inflation Linked) of this Report, RPI is expected to be brought in line with CPIH from 2030 and therefore the impact as a result of basing the salary/earnings growth on RPI or CPI will be decreasing. Selecting the base for the increase will be subjective, as will setting the margin above inflation which is likely to be more volatile in the short term.

Difference between S148 Orders and RPI Inflation



Difference between S148 Orders and CPI Inflation



Overall we consider it appropriate to change the future earnings assumption from the RPI + 2% p.a. contained in the previous guidance to better meet the FCA's objectives. We propose that an assumption for future earnings growth (used for both S148 orders and salary growth for opt-out/non-joiner cases) of CPI + 1.0% p.a. is adopted.

This assumption represents a pragmatic approach to setting a subjective assumption.

[1]SIB Pens Review Part II Specification of standards and procedures pp1-41 (inc transfers)
[2]https://obr.uk/efo/economic-and-fiscal-outlook-march-2022/

Assumptions & Methodology – Other

Enhanced Transfer Values (ETVs)

Consumers may have been offered an Enhanced Transfer Value (ETV) as an 'incentive' to transfer out of their original DB Scheme. Pre 2012 the enhancement was often paid as cash to the consumer.

The value of any cash enhancement paid directly to the consumer as part of the ETV should be included in the redress calculation. It is therefore necessary to have an assumption as to how this cash enhancement has increased since it was paid.

The prevalence of ETV exercises has decreased significantly in recent years, and the payment of any enhancements as cash was primarily prevalent pre 2012. Therefore this assumption is not expected to be required for the majority of DB transfer redress calculations going forwards.

Under the current FG 17/9 Guidance the cash enhancement is rolled up from the date of payment to the Date of Calculation using 50% of the return on the FTSE100 Total Return Index. This is consistent with the current methodology for setting the pre-retirement discount rate assumption which is based on 50% of the return on equities.

The actual known return on the personal pension fund to date is an alternative approach which has been considered in the past. We note that during the 2017 Consultation the FCA stated *"we favour [the FTSE100 Total Return] approach over applying the growth of the personal pension to the cash enhancement*" as it provides *"a fairer outcome".* There have been no fundamental changes since 2017 which would lead to different considerations being relevant. Therefore adopting an approach consistent with the pre-retirement discount rate assumption is still considered appropriate.

Whilst we have proposed changes to the underlying elements of the pre-retirement discount rate, the fundamental principle of targeting half the return on equities has been retained.

Based on the FCA's objectives, we propose that the current approach of cash enhancements being rolled up from the date of payment to the Date of Calculation using 50% of the return on the FTSE100 Total Return Index is retained.

As set out in Section 5e (Methodology: Charges) of this Report, we are proposing that charges incurred by the consumer in their personal pension fund are continued to be allowed for in the pre-retirement discount rate by 'netting' them off the assumed return. Consideration should be given as to whether an adjustment to the return on the FTSE100 Total Return Index should be made for the ETV payments for similar charges.

Under the current FG 17/9 Guidance, the return on the FTSE100 Total Return Index is used net of personal pension charges for each year, (as per Section 5e (Methodology: Charges) of this Report), and the figure added to the value of the consumer's personal pension policy. We propose that the existing approach of netting off personal pension charges is retained.

Treatment of DB schemes entering the PPF

Some DB schemes will have either entered the PPF or be in the PPF Assessment Period at the date of the redress calculation. The benefits the consumer will receive from the PPF will typically be lower than those provided by the original DB scheme.

Where a DB scheme has already entered the PPF, the DB scheme benefits should be valued in line with PPF benefits as this reflects what the consumer would have received if they had not transferred out, and therefore more accurately returns them to the position they would have been in.

When a scheme is in the Assessment Period for the PPF, benefits are generally administered in line with PPF levels. Therefore we consider it to be reasonable to reflect this in the redress calculation.

However, there will be a variety of different situations for individual schemes and so it may be necessary to apply a principles based element to the redress methodology for this. For example, there may be knowledge that the scheme is shortly going to exit the Assessment Period (potentially with benefits secured outside of the PPF at a higher level than PPF benefits).

There may be cases where a DB scheme is in the PPF Assessment Period, redress is calculated based on a PPF level of benefits but the DB scheme ultimately exits the PPF Assessment Period and members' benefits are secured at a level higher than PPF level. In this scenario it may be appropriate for impacted consumers to receive a 'top up payment' to account for any shortfall in the redress amount as a result of this. This top-up payment would represent the difference between their original redress amount and the redress calculated based on the secured benefits.

However, there is a second order impact to consider. If consumers had not transferred out of the DB scheme, then the funding level of the DB scheme would have been different and thus the level of benefits secured outside the PPF (above PPF level) would have been different for all members. The FCA may wish to consider the practicality and legal process for claiming and making such payments.

The PCLS factors used by the PPF are generally not in line with those used by DB schemes and therefore consideration could be given as to whether a different approach should be applied for PCLS for schemes which have entered the PPF.

The adjustment adopted for PCLS in Prospective Loss cases is based on a general basis, rather than being scheme specific. Therefore we consider that no adjustment should be made to the approach to allow for PCLS for schemes in the PPF for Prospective Loss cases. The standard approach for allowing for a PCLS as set out in Section 5b (Assumptions: Post-retirement Discount Rate) of this Report would apply.

Assumptions & Methodology – Other

Separate Lump Sums, AVC funds

Separate Lump Sums

Where a separate lump sum benefit is provided by the DB scheme, there is consideration needed as to whether or not to include the standard PCLS adjustment within the post-retirement discount rate, as consumers with a separate lump sum are less likely to commute pension for cash.

The current FG 17/9 Guidance states: *"This may be modified to reflect . . . where the PCLS was additional to pension income in the original scheme".* We consider that this should be made more prescriptive to achieve greater consistency across the industry.

We propose that where a lump sum was an additional benefit to the pension income in the DB scheme, making no allowance for cash commutation would be in line with the FCA's objectives. Further details on the approach for allowing for PCLS in both Prospective and Actual Loss cases is set out in Sections 5b and 6 of this Report.

AVC funds

There will be cases where a consumer had an AVC fund or DC section within the DB scheme and where the DB scheme allowed the PCLS to be taken from those sources before commuting DB pension.

This means that the consumer would have commuted less of their DB pension than the 25% assumed by the standard PCLS adjustment within the post-retirement discount rate, as they would have commuted pension from their AVC fund/ DC section first.

In order to allow for this in a Prospective Loss calculation would require the AVC fund / DC section to be projected to assumed retirement age and a calculation undertaken of the maximum PCLS that could be commuted (which would require an assumed DB scheme PCLS factor) to determine the proportion of the DB pension that would be commuted.

This would then need to be converted back into an equivalent adjustment to the post-retirement discount rate so as to be consistent with the treatment of other Prospective Loss cases.

Assumptions & Methodology – Other

Interest & Tax

Interest to be applied to past payments

An assumption is required for the interest rate that should be applied to various payments to increase them from date of payment to Date of Calculation. This is particularly relevant for Actual Loss cases where there is a 'Past Loss'.

Details on the approach we propose is adopted is set out in Section 6 (Actual Loss) of this Report. The comments there will equally apply for any Prospective Loss cases where such an interest assumption is required (excluding ETV cash payments which are covered separately).

Tax

Consideration of the tax implications of the payment of redress (either into a personal pension or as a cash lump sum) are excluded from the scope of our work. However, the FCA may wish to obtain specialist tax advice in respect of this for inclusion as part of the consultation.

FG 17/9 provides over-arching considerations for firms. However, there remains the potential for ambiguity and thus inconsistent practices across the industry in respect of allowance for tax considerations in the payment of redress to consumers.

Particular areas for consideration could include:

- 'Netting off' of tax at the client's marginal rate (with an allowance for 25% tax free)
- Allowing for the impact on Means-Tested benefits
- Annual Allowance and Lifetime Allowance implications

Assumptions & Methodology – Other

FSAVC calculations

Most redress calculations are for consumers who have been incorrectly advised to either transfer or opt-out of a DB pension scheme. Some consumers will have instead received unsuitable advice relating to their Free Standing Additional Voluntary Contribution ("FSAVC") policy. Typically consumers will have unsuitably been advised to:

- Take out an FSAVC policy instead of joining their employer's in house AVC policy; or
- Invest in their employer's AVC policy instead of purchasing "added years" in their employer's DB pension scheme.

The Financial Services Authority ("FSA") required firms to carry out a review of FSAVC policies sold between 29 April 1988 and 15 August 1999. This review was known as the FSAVC Review. As part of the FSAVC Review, the FSA[1] published guidance on how redress calculations should be undertaken for FSAVC cases.

We consider that this guidance broadly remains appropriate for calculating redress for FSAVC cases.

However, one area we believe is no longer appropriate is the benchmark index used to model fund performance of the FSAVC and in house AVC policies. The FSAVC Review Model Guidance states that the CAPS 'Mixed With Property' Fund should be used as a benchmark index, however data for this fund is not available after 1 January 2005.

We note that the Financial Ombudsman Service ("FOS") advise Redress Providers to use the CAPS 'Mixed With Property' Fund up to 1 January 2005, and then the FTSE UK Private Investor Growth Total Return Index post 1 January 2005. We understand that FOS consider that this index provides the closest match to the CAPS index[2].

In our view the FTSE UK Private Investor Growth Total Return Index is an appropriate replacement for the CAPS 'Mixed With Property' Fund.

Based on the FCA's objectives, we therefore propose that the benchmark index used in FSAVC redress calculations should be:

- The CAPS 'Mixed With Property' Fund up to 1 January 2005; and
- The FTSE UK Private Investor Growth Total Return Index post 1 January 2005.

We are aware that the FTSE UK Private Investor Growth Total Return Index is not freely available publicly and a subscription may be required to access it. However, this index has been used for FSAVC calculations for a number of years, including by the FOS. We therefore consider it remains appropriate to use as the benchmark index.

[1] *"FSAVC Review Model Guidance" dated May 2000, as issued by the FSA*
[2] *www.financial-ombudsman.org.uk/businesses/complaints-deal/pensions-and-annuities/additional-voluntary-contribution-schemes*

Assumptions & Methodology – Other

Overall Conclusions

Overall we propose small amendments to the existing approach for setting the assumptions/methodologies to better meet the objectives set out earlier.

Current Approach

Retirement Age: The earliest age at which the customer could have retired from the DB Pension Scheme without both:

- Requiring the consent of the employer; and
- Suffering a reduction in benefits

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

Earnings Growth: *No explicit wording in the current FG 17/9 Guidance*

Enhanced Transfer Values: Where a cash enhancement was paid in addition to the transfer value, the cash enhancement should be rolled up from the date of payment to the calculation date using 50% of the return on the FTSE100 Total Return Index. This should be net of personal pension charges for each year, as determined previously, and the figure added to the value of the consumer's personal pension policy.

Proposed Approach

Retirement Age: The earliest age at which the consumer could have retired from the DB Pension Scheme without both:

- Requiring the consent of the employer; and
- Suffering a reduction in benefits

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

Earnings Growth: An assumption for future earnings growth (used for both S148 orders and salary growth for opt-out/non-joiner cases) of CPI + 1.0% p.a. should be adopted.

Enhanced Transfer Values: Where a cash enhancement was paid in addition to the transfer value, the cash enhancement should be rolled up from the date of payment to the calculation date using 50% of the return on the FTSE100 Total Return Index. This should be net of personal pension charges for each year, as determined previously, and the figure added to the value of the consumer's personal pension policy.

Assumptions & Methodology – Other

Overall Conclusions

Overall we propose small amendments to the existing approach for setting the assumptions/methodologies to better meet the objectives set out earlier.

Current Approach

Pension Protection Fund (PPF): A respondent should consider how far they should take into account any adjustment to the benefits which the customer would have been eligible for under the DB scheme including the scheme entering the Pension Protection Fund.

Separate Lump Sums: The PCLS adjustment may be modified to reflect where the PCLS was additional to pension income in the original scheme

Tax: The redress lump sum should be adjusted to take account of the customer's individual tax position.

FSAVCs: FSAVC Review Model Guidance states that the CAPS 'Mixed With Property' Fund should be used as a benchmark index for modelling fund performance.

Proposed Approach

Pension Protection Fund (PPF): Where the original DB scheme has already entered the PPF, the DB scheme benefits should be valued in line with PPF benefits.

When a DB scheme is in the Assessment Period for the PPF, the DB scheme benefits should be valued in line with PPF benefits unless there is knowledge that the scheme is shortly going to be secured outside of the PPF and members receive higher benefits.

Separate Lump Sums: Where the pension commencement lump sum was an additional benefit to the pension income in the DB scheme no allowance should be made for cash commutation.

Tax: *Outside the scope of this review*

FSAVCs: the benchmark index used for fund performance in FSAVC redress calculations should be:

- The CAPS 'Mixed With Property' Fund up to 1 January 2005; and
- The FTSE UK Private Investor Growth Total Return Index post 1 January 2005.

Assumptions & Methodology – Other

Future review

Future review

Unless there are any material changes to the sources underlying the analysis of the elements in this section, we would expect that a review of the approach would only be undertaken as part of a wider review of the redress methodology and should not require specific individual timelines.

5h. Methodology: GMP Equalisation

Methodology – GMP Equalisation

Background

Background

Historically, guaranteed minimum pension ("GMP") entitlements would have been payable from age 60 for women and age 65 for men (reflecting the different state pension ages which prevailed at that time). Further, women earned GMP at a faster rate reflecting that their working life was five years shorter.

Court cases over the years have meant that schemes and their sponsoring employers need to adjust members' benefits to equalise for the effect of unequal GMPs between men and women.

GMP equalisation needs to include:

- Current members' benefits (including retirement pensions, transfers out and any other lump sum payments); and
- Most past members (including members who have transferred out).

There are significant challenges in reliably estimating the additional cost to schemes of undertaking GMP equalisation for historic transfers. For example:

- The data required may no longer exist or be complete. In many cases, schemes will no longer hold details of the ex-members or what benefits they built up in the scheme.
- Interest should be applied on any underpayments based on the Bank of England's base rate plus 1% but, if members can prove further loss as a result of GMP equalisation, further compensation/interest may need to be applied.
- In general, trustees need to be proactive in paying out top-ups to ex-members, however there are circumstances where this may not be the case. Certain transfers (e.g. those that are one year from retirement or done on a bulk basis) may be "Non-Statutory" transfers and may not require the same level of proactivity.

The impact on consumers

Not all consumers will be impacted by GMP equalisation. For past transferees who are impacted we would expect equalisation to be in the form of an additional lump sum paid to the member. This will be calculated by the original DB scheme and be based on the approach which they consider appropriate for the scheme.

Due to the vast complexity of the calculations and the multiple number of possible approaches for schemes to consider, the process of GMP equalisation is not going to be completed quickly and it will be a number of years before all impacted members are equalised. However, theoretically the transferees will receive their compensation from the original DB scheme and therefore it should not be necessary for the actual GMP equalisation compensation to be included in any redress amount.

Over the next few years we expect more and more transfer cases to receive their GMP equalisation payment, so any redress guidance on this needs to reflect the changing position of equalisation.

There is a question as to whether the treatment of remaining members and transferees will be the same and therefore whether the objective of putting the member back in the position they would have been if they had remained in the scheme needs to be considered. This will not be known until the original DB scheme has actually equalised benefits and could differ from scheme to scheme.

Methodology – GMP Equalisation

The impact on redress

The impact on redress – second order effect

A key element to consider is around the difference in value placed on the 'equalised uplift' by the original DB scheme and that which would be placed on it using the FG 17/9 Guidance.

This 'second-order' effect is as a result of the different calculation bases and will apply to all transferees. This could, theoretically, be calculated once the GMP equalisation uplift had been paid to the consumer (or at least the value is known) from the DB scheme.

However, issues such as complex calculations, multiple methodologies, complex member impacts and tax implications will make this challenging in practice. Introducing this into the redress methodology needs to balance the improved accuracy of the calculation with the risk it introduces inconsistency across the market and placing reliance on calculators undertaking complex calculations.

An alternative would be to apply a blanket adjustment to impacted members (e.g. a fixed percentage uplift on their GMP benefits). However this would introduce the possibility of over/ under-compensating consumers. The amount of true uplift will vary based on a number of factors.

Generally, we may expect to see members having an average c.1% uplift in value applied to their pension for GMP equalisation, although we acknowledge that this uplift could be up to c.20-30% in some circumstances. The 'second-order' effect (between the uplift provided by the DB scheme and the value on the FG 17/9 basis) which any redress would be seeking to reflect would be a smaller proportion of benefits and therefore may be considered immaterial in the majority of cases.

For consumers where their uplift amount has not been calculated by the original DB scheme, it would be necessary to calculate the GMP equalisation amount first, for which there may be two possible approaches:

1. **A full calculation of the consumer's GMP equalisation benefits:** Due to the complexity of the exercise, actuaries would need to calculate the uplift using complex modelling. In order to do so, data would need to be readily available. This data may no longer exist or it might be impossible or impracticable to obtain. There will also be concerns of validity and accuracy of any such data.

2. **Factor based approach:** This approach is less computationally complex and a factor could be applied to the GMP pension amount in redress calculations and consequently an allowance made in the redress amount. However, relying on the redress calculator to use a 'book' of factors accurately and make allowance for individual benefit elements (such as anti-franking) may result in errors from gaps in knowledge in application.

Rather than the prescription of the approaches above, the redress methodology could include a principles based requirement such as the requirement for Redress Providers to "consider the impact of GMP equalisation". This approach may lead to Redress Providers not undertaking calculations where an amount was theoretically due. However, noting that any amount from the 'second-order' effect will likely be small and the other issues noted in this Report, it may be considered by the FCA that this is a pragmatic approach consistent with the materiality of the potential impact and your overall objectives.

The FCA may wish to seek views in the consultation on this.

6. Actual Loss

Actual Loss

Current approach

The SIB documentation from the Pensions Review (*SIB Pensions Review Part II: Specification of standards and procedures (paragraph 405)*), defines the two categories of redress calculations as:

- ***Actual Financial Loss:*** *When an event (such as death or retirement) has already occurred giving rise to benefits and the benefits from the personal pension are less than those the occupational pension scheme would have conferred*
- ***Prospective Financial Loss:*** *Where the investor (or his/her spouse or dependants) is exposed to the probability of an actual financial loss when an event such as retirement or death occurs in the future*

FG 17/9 defines an Actual Loss case as: *'Actual loss cases occur where the customer has retired, died, or both'*. It is acknowledged that the current FG 17/9 Guidance primarily focuses on Prospective Loss cases.

Whilst the underlying methodology for determining the financial and demographic assumptions in FG 17/9 would apply to Actual Loss cases there are certain additional assumptions/ methodology points that are required for Actual Loss cases which have not been reviewed since the Pension Review. In light of the freedom and choice in pensions introduced from April 2015, there is a need for clear guidance relating to the specifics of Actual Loss cases to reduce the risk of ambiguity and inconsistency in approaches across the industry.

In our experience the proportion of redress calculations which are being treated by Redress Providers as Actual Loss (rather than Prospective loss) is increasing due to consumers accessing benefits earlier in a DC environment and an aging population of consumers with former DB benefits. With the introduction of freedom and choice in April 2015, when accessing benefits in the DC scheme, consumers are now typically entering drawdown and not purchasing an annuity. Therefore the consumer's actions in the DC scheme does not necessarily indicate what they would have done in the DB Scheme.

As a result, clear guidance relating to the specifics of Actual Loss cases is becoming increasingly important for the industry. This is particularly required in respect of what 'retired' means for Actual Loss cases in the context of pension freedoms.

The current FG 17/9 Guidance includes the following in respect of Actual Loss cases:

Assumed retirement age: Actual loss cases occur where the customer has retired, died, or both.

Approach to allowance for PCLS: The final rate (post retirement discount rate) adjusts for the pension commencement lump sum by taking:

- 75% of the initial rate, plus
- 25% of the initial rate plus 1.6%

This may be modified to reflect actual pension commencement lump sum percentages for actual loss cases or where the pension commencement lump sum was additional to pension income in the original scheme.

Marital Status: The actual marital status at date of crystallisation should be used, if known.

Actual Loss

Key considerations

We consider the following to be key issues to consider in respect of determining an appropriate approach for Actual Loss cases:

- How should an 'Actual Loss' case be defined. In particular:
  - How should 'retirement' be defined in the context of pension freedoms, changes in consumer behaviour towards retirement and the current definition of Actual Loss cases?
  - Should the way in which consumers have accessed benefits in the DC scheme be factored into whether a case is defined as 'Actual Loss'?
  - Based on the above, what age should a consumer be assumed to have access their benefits in the DB scheme if they had not transferred?
- How should PCLS be allowed for (i.e. an adjustment to the post-retirement discount rate, in line with Prospective Loss cases, or based on DB scheme specific factors)?
- What default assumptions for Early Retirement Factors, Late Retirement Factors and PCLS Factors should be adopted where this information is not available from the DB scheme?
- How should past payments be valued?
- How should redress be paid? As a lump sum (consistent with the approach for Prospective Loss) or requiring the purchase of an annuity to replicate the DB scheme benefits?

Some decisions in respect of the approach to adopt for Actual Loss cases will be subjective and careful consideration will be needed to reduce the risk of either over or under compensating consumers.

Key objectives for this section include:

- Appropriate redress must, as far as possible, put the consumer into the position they would have been in if they had received compliant advice.
- To reflect current practices for taking benefits from pension schemes they would have been in but for the act or omission by the firm.
- To take account of factors such as recent and future changes to the pensions landscape, the availability of data, and actuarial standards and best practice to ensure the redress methodology and assumptions are as robust as possible over an extended period of time.
- To ensure consistency of approach between firms carrying out the calculation.
- To ensure clarity and minimise the scope for ambiguity in the application of the methodology and guidance, minimising the risk that the approach to calculating redress can be misinterpreted or manipulated.
- To enable those who undertake redress calculations or provide redress software to understand the rationale behind the methodology and assumptions and be able to apply it readily in practice.
- To ensure key elements of the redress calculation to be transparent and explainable to consumers.

Actual Loss

How should an 'Actual Loss' case be defined?

Background

How to define 'Actual Loss' in the current pensions environment following the introduction of pension freedoms in April 2015 is the most fundamental point to address. The redress methodology will need to answer the question of 'What is an Actual Loss case'?

It is important to understand that there is no 'correct' answer to the approach to be adopted. There will be 'winners' and 'losers' under any approach where the specific circumstances of the case differ to the generalised principles of the approach adopted.

FG 17/9 defines an Actual Loss case as: *'Actual loss cases occur where the customer has retired, died, or both'*. The SIB documentation from the Pensions Review defines Actual Loss as: *When an event (such as death or retirement) has already occurred giving rise to benefits and the benefits from the personal pension are less than those the occupational pension scheme would have conferred.*

In the Pension Review documentation, assuming that a consumer would have accessed their DB benefits at the same date they accessed benefits in the DC scheme (i.e. 'retired') was considered a reasonable assumption. This is due to the fact that the majority of consumers would have purchased an annuity with the DC fund (i.e. a guaranteed regular stream of payments which is consistent with what they would have received from the DB scheme).

However, with the introduction of freedom and choice in 2015, when accessing benefits in a DC scheme, consumers are now typically entering drawdown and not purchasing an annuity. Therefore the consumer's actions in the DC scheme does not necessarily indicate what they would have done in the DB Scheme.

The key area to clarify is in respect of what 'retired' means in this context (and therefore what age the consumer is assumed to retire in the DB scheme if they had not transferred) given the range of ways in which consumers now access benefits in a DC environment.

We consider that there are three primary approaches for consideration in terms of the retirement age to assume in the calculation of the value of the DB scheme benefits:

A) The same age as the consumer first accessed benefits in the DC scheme (regardless of how the benefits have been accessed)

- This is broadly in line with the current guidance for Actual Loss cases (if accessing benefits in the DC scheme is defined as 'retirement')

B) The earliest age the consumer can take benefits unreduced in the DB scheme

- This is in line with the approach for Prospective Loss cases and would ignore how the consumer has accessed benefits in the DC scheme.

C) An approach which differs on a consumer by consumer basis, depending on how the consumer has accessed benefits in the DC scheme and the consumer's circumstances

We note that the approach A will typically lead to materially lower redress than approach B (see next page). Approach B has significant practical advantages and simplifications, but has the potential to over-compensate.

Actual Loss

The impact of using a Prospective Loss vs an Actual Loss approach

The potential impact

Whether a case is calculated on a Prospective Loss or an Actual Loss basis (under the current redress methodology) can have a material impact on the level of redress due. Whilst it depends on the specific early retirement and PCLS factors of the DB scheme, broadly the earlier a consumer is assumed to access benefits (and thus the earlier the retirement age assumed in the DB scheme), the lower the redress. Therefore approach A would typically result in lower redress than approach B.

We have set out illustrative redress calculations for an example consumer under the current redress methodology to demonstrate valuing the DB benefits on a Prospective Loss basis (i.e. approach B) compared to on an Actual Loss basis (i.e. approach A): The over-arching assumptions in the illustrative calculations are:

Prospective Loss Basis:

- Assumed to retire at earliest age unreduced in the DB scheme: Age 65
- Allowance for PCLS is made via an adjustment to the Post Retirement Discount Rate (in line with FG 17/9)
- Allowance for 85% proportion married regardless of actual marital status (in line with FG 17/9)
- Assumed charges of 0.75% p.a. (pre-retirement)

Actual Loss Basis:

- Assumed to retire at age accessed benefits in the DC scheme
- Early retirement factor of 5% p.a. compound
- PCLS factor of 15.0. PCLS factors in DB schemes can vary significantly between a range as large as 9 to 35. The smaller the factor the lower the value placed on the DB benefits. The individual is assumed to commute the HMRC maximum from the DB scheme.

The illustrative calculations are based on the following example consumer which we consider is a reasonable example of a typical DB member and typical benefits:

- **Date of Calculation**: 01/04/2022 (based on assumptions based on market conditions at 31/03/2022)
- **Date of Birth**: 01/01/1961 (the individual is aged 61.25)
- **Date of Leaving the DB Scheme**: 01/01/2012
- **Pension at Date of Leaving (01/01/2012)**: £1,000 p.a.
- **Pension revaluation in deferment:** CPI capped at 5% p.a. over the whole deferment period
- **Pension increases in payment:** RPI capped at 5% p.a.
- **Spouse's pension (death in payment)**: 50% of the pre commuted pension

Based on the above assumptions, we have calculated the value of this illustrative member's DB benefits at 1 April 2022 in line with the current FG 17/9 Guidance.

Case Type	Value placed on DB scheme benefits	Reduction in value compared to Prospective Loss calculation
1. Prospective Loss	£41.9k	-
2. Actual Loss: Assumed retirement age 60, Married	£36.7k	12%
3. Actual Loss: Assumed retirement age 60, Single	£32.0k	24%
4. Actual Loss: Assumed retirement age 55, Married	£31.7k	24%
5. Actual Loss: Assumed retirement age 55, Single	£27.9k	33%

The percentage reduction in the actual redress amount would be greater as the value of the DC benefits would be unchanged. As an example, assuming the value of the DC benefits was £25k:

- Under Scenario 1: Prospective Loss, the redress amount would be £41.9k – £25k = £16.9k
- Under Scenario 5: Actual Loss (assumed retirement age 55 and single), the redress amount would be £27.9k – £25k = £2.9k

This equates to a c.83% reduction in redress compared to the Prospective Loss approach.

Actual Loss

Changes to the pensions landscape since the Actual Loss methodology was introduced

The changing pensions landscape post Freedom and Choice

In the Pension Review, assuming that a consumer would have accessed their DB benefits at the same date they accessed benefits in the DC scheme may have been considered a reasonable assumption. This is due to the fact that the majority of consumers would have purchased an annuity with the DC fund.

However, with the introduction of freedom and choice in April 2015, when accessing benefits in the DC scheme, consumers are now typically entering drawdown and not purchasing an annuity. Therefore the consumer's actions in the DC scheme do not necessarily indicate what they would have done in the DB Scheme.

Consideration should be given to determining the approach based on assessing (on a case by case basis) at what age the consumer would have been expected to have retired in the DB scheme.

The FCA has published data (in December 2021) on 'Retirement income market data' which provides details on how pension plans are accessed for the first time by consumers over the period to March 2021[1].

This evidences that over the period April 2018 to March 2021, the way in which consumers accessed their DC funds for the first time was:

Method of access	Percentage of consumers
Annuity*	11%
Plans entering income drawdown and not fully withdrawn	29%
Plans with first uncrystallised fund pension lump sum (UFPLS) payment and not fully withdrawn	5%
Plans fully withdrawn**	56%

Source: FCA publication: Retirement income market data [1]

** We understand that this may include consumers with Guaranteed Annuity Rates and Section 32 policies.*

***By plan holders accessing their plans for the first time via small pot lump sum, drawdown or UFPLS.*

The FCA has noted that c.9 out of 10 of the instances where the 'Plans fully withdrawn' relates to pot sizes less than £30,000. Given the nature of DB pension transfers and the requirement to obtain advice only relating to transfer values in excess of £30,000, we would not expect this cohort to be representative of the advised DB pension transfer population (and has not influenced our proposals in respect of the redress methodology).

Nonetheless, the data evidences that the majority of consumers are not purchasing an annuity at retirement when they initially access their benefits. This evidences the materially different pensions landscape and consumer behaviour currently evident relative to that at the time of the Pension Review and the original definition of Actual Loss being created. The previous review of the redress methodology in 2016/17 was also undertaken before the full impact of these changes on consumer behaviour had been seen.

[1]www.fca.org.uk/data/retirement-income-market-data-2020-21

Actual Loss

Analysis of the options for defining an Actual Loss

Comparing approach A and approach B

Approach A: Assumed to retire in the DB Scheme at the same age as first accessed benefits in the DC scheme (regardless of how the benefits have been accessed): This is broadly in line with the current guidance for Actual Loss cases (if accessing any benefits in the DC scheme is defined as 'retirement')

Approach B: Assumed to retire in the DB Scheme at the earliest age the consumer can take benefits unreduced in the DB scheme: This is in line with the approach for Prospective Loss cases and would ignore how the consumer has accessed benefits in the DC scheme.

Each approach has relative strengths and weaknesses depending on the specific circumstances of each individual consumer.

Over/ under compensating

Typically approach A will:

- undercompensate consumers who would not have accessed their benefits in the DB scheme at the age they accessed benefits in the DC scheme.
- appropriately compensate consumers who would have accessed their benefits in the DB scheme at the age they accessed benefits in the DC scheme.

Typically approach B will:

- appropriately compensate consumers who would have accessed their benefits in the DB scheme at the earliest age they could take benefits unreduced, not at the age they accessed benefits in the DC scheme.
- over-compensate those consumers who would have accessed their benefits in the DB scheme at the age they accessed their benefits in the DC scheme.

Consistency

Approach A is broadly consistent with the industry approach (subject to how Redress Providers interpret 'retirement') and thus provides consistency with calculations undertaken historically.

Under approach A, there is potential for a significant 'cliff edge' between if a calculation is undertaken on a Prospective Loss basis or an Actual Loss basis. For example, if one year, a consumer receives a calculation on a Prospective Loss basis, the consumer accesses benefits in the DC scheme and then it is calculated as an Actual Loss the following year. Typically a redress offer would only be made once and this scenario would not occur. However, we are aware of firms who provided a 'guarantee' in respect of redress calculations from the Pension Review, who do provide consumers with the option to obtain a redress quotation annually.

Approach B avoids any cliff edge and results in a consistent valuation of the DB scheme benefits regardless of what the consumer does with their DC benefits.

Actual Loss

Analysis of the options for defining an Actual Loss

Efficiency and minimising delays

Approach A requires data gathering from the original DB scheme, in particular to obtain the early retirement/ late retirement and PCLS factors in force at the date of assumed retirement age. Depending on the DB scheme, this can take weeks/ months. This is required to accurately reflect what would have happened in the DB scheme.

This approach would also require the redress methodology to set out what should be assumed where it is not possible to obtain the early retirement and/ or PCLS factors.

Approach B does not require any data gathering of this nature. The consumer is assumed to retire at the earliest age unreduced in the DB Scheme and thus there is no need to obtain early retirement factors. PCLS would be allowed for in a consistent way to Prospective Loss cases (i.e. an adjustment to the post retirement discount rate).

Ease of explanation

Both approach A and approach B would be relatively easy to explain to consumers. However, as they are a simplification and are applied to all cases, there is likely to be challenge from consumers where the approach does not reflect their specific circumstances.

Actual Loss

Analysis of the options for defining an Actual Loss

Approach C

Approach C: An approach which differs on a consumer by consumer basis, depending on how the consumer has accessed benefits in the DC scheme and the consumer's circumstances.

Approaches A and B are binary and will result in consumers being over/ under compensated based on their personal circumstances and whether they would have accessed benefits in the DB scheme at the same age as in the DC scheme.

Approach C seeks to more accurately reflect each consumer's circumstances to reduce the risk of over/ under compensating. This is considered important given the material impact of undertaking a calculation on a Prospective Loss basis compared to an Actual Loss basis can have.

Under Approach C, the approach to determine whether a case should be valued on a Prospective Loss or an Actual Loss basis, could differ depending on how the consumer accessed benefits in the DC scheme:

- **Annuity**: Where a consumer has purchased an annuity, then it would be considered reasonable to assume that they would have accessed benefits in the DB scheme at the same age. This is consistent with the rationale adopted for the Pension Review and would lead to consistency of approach in providing redress for cases of this nature.
- **PCLS only**: Where a consumer has only accessed PCLS, then it is unlikely to be appropriate to automatically assume that they would have accessed benefits in the DB scheme at the same age.
- **Drawdown:** There are a range of drawdown scenarios, from taking a large lump sum combining PCLS and taxable income, to setting up a steady stream of regular withdrawals. The approach to adopt would depend on the consumer circumstances and the nature of the drawdown payments.
- **Full withdrawal (in one lump sum):** We consider this to be an unlikely scenario for the DB transfer population given the average transfer size. The approach to adopt would depend on the consumer circumstances.

Approach C would be expected to more accurately reflect a consumer's actual intentions to access benefits in the DB scheme and thus more accurately determine appropriate redress.

For cases where a consumer has purchased an annuity in the DC scheme, we consider it is in line with the FCA's objectives to determine that as their 'retirement' for redress purposes. Therefore the calculation of redress should be undertaken assuming they retired at that date in the DB scheme (consistent with the current approach to Actual Loss cases).

For cases where a consumer has only accessed PCLS and not any income in the DC scheme, we would not typically expect it to be appropriate to determine that as their 'retirement' for redress purposes. If this is the case the calculation of redress should be undertaken assuming that the consumer has not yet retired (i.e. valuing the DB benefits on a Prospective Loss basis) unless there is other information supporting this retirement date (see next page for 'indicators of retirement').

Actual Loss

Analysis of the options for defining an Actual Loss

It is extremely challenging to be prescriptive as to what approach should be adopted for drawdown (and full withdrawal) cases to cover all possible scenarios. If approach C is adopted, then the redress methodology will need to provide principles, indicators and/or examples to enable Redress Providers to determine whether a consumer has would have retired in the DB scheme and thus whether the DB scheme benefits should be valued on a Prospective Loss or an Actual loss basis. This will ultimately require a level of judgement from the redress calculator and appropriate disclosure to the consumer as to the judgement exercised.

We have had discussions in respect of this approach with the FCA and FOS. We have set out on the following pages the outcome of these discussions. We consider that it is ultimately an FCA policy decision in respect of the approach to be proposed and consulted on for Actual Loss.

Indicators of retirement

Drawdown cases: Indicators of retirement

It was discussed with the FCA and FOS that it may no longer be considered appropriate to assume a consumer 'retires' at the same age as they first access benefits in the DC scheme in all cases.

Following these discussions, we consider that the redress methodology could be written so that:

- The default/ starting assumption is that the consumer would retire in the DB scheme at the earliest age they can take benefits unreduced (i.e. consistent with Prospective Loss cases) regardless of when / how they accessed their benefits in the DC scheme.
- Redress Providers would then be expected to use their judgement on the particular circumstances of the consumer to determine whether they should move away from this starting assumption, and assume that the consumer would have retired at the age they accessed benefits in the DC scheme (and thus undertake the calculation on an Actual Loss basis).
- To enable this, the redress methodology could include a range of 'indicators' for Redress Providers to consider when reaching a conclusion.
- This would allow for individual circumstances to be taken into account for the consumer and may increase the accuracy of individual redress calculations. However, it was acknowledged that this would require an element of judgement to be exercised by Redress Providers and introduces a risk of inconsistent approaches.

If this approach is adopted, when communicating a redress offer to consumers, it will be important to set out the factors that have been considered in making the decision on their assumed retirement date (and thus whether the case has been calculated on a Prospective Loss or Actual Loss basis).

Ultimately, if a consumer believed that the assumptions made in respect of retirement age were unrealistic, they would still have a right to approach the FOS.

Caution needs to be taken in analysing the difference between what the consumer would have done in the DB environment and what they have done in the DC environment, noting that a consumer's behaviour post transfer is often driven by the unsuitable advice received and the pensions environment they are now in.

The following 'indicators' were discussed with the FCA and FOS. We have set out below a summary of the indicators discussed and the key decisions we consider are required by the FCA in respect of this approach.

Indicator 1: How a consumer has accessed benefits in the DC Scheme

Consideration would need to be given to the nature of the withdrawals (timing and size) as well as over what time period they have occurred.

An indicator could be: *A 'regular' stream of withdrawals over a 'period of X years'.* If there was evidence that the consumer had taken 'regular' withdrawals from their drawdown fund over a 'period of X years', this would be a strong indicator (in isolation) that the consumer has 'retired'. In this scenario it could be assumed that the consumer would have accessed benefits at that age in the DB scheme and thus the case should be calculated on an Actual Loss basis.

However, the FCA would need to decide/ consult on:

- Regular: Consideration would be required as to what 'regular' means (e.g. a percentage of the fund, the amount withdrawn each time and the continuity of the withdrawals).
- Period of X years: Would there be a need to prescribe a minimum time period over which withdrawals would need to be demonstrated? It is noted that it is likely to create challenge where the consumer only started drawdown a short period before the redress calculation (i.e. before X years).

Actual Loss

Indicators of retirement

Indicator 2: Employment actions

The consumer's employment status could be an indicator of planned retirement age in the DB scheme.

In particular, whether the consumer is still working or has 'retired' from work and whether this aligns with the date they accessed benefits in the DC scheme.

Where a consumer has ceased employment and this was on a date broadly consistent with accessing benefits in the DC scheme, this would be an indicator (in isolation) that the consumer has 'retired'. In this scenario it could be assumed that the consumer would have accessed benefits at that age in the DB scheme and thus the case should be calculated on an Actual Loss basis.

However, careful consideration would be needed in circumstances where a consumer has reduced their working hours, potentially to supplement monies taken from the DC scheme. Caution is also needed as to whether the consumer's approach to retirement and ceasing work could have been influenced by the unsuitable advice and the fact they are in a DC environment rather than a DB environment.

Indicator 3: Ask the consumer

As part of the redress process the consumer could be asked to explain in their own words why they accessed benefits in the DC scheme at the age they did and the format they did.

Where a consumer provides a clear rationale for their retirement age which is not directly linked to the flexibilities provided by their DC fund, this would be an indicator (in isolation) that the consumer would have accessed benefits at that age in the DB scheme and thus the case should be calculated on an Actual Loss basis.

Indicator 4: Planned retirement age at the time of the DB transfer advice

The consumer's planned retirement age at the date of advice could be an indicator of planned retirement age in the DB scheme (and thus that the consumer would have accessed benefits at that age in the DB scheme and thus the case should be calculated on an Actual Loss basis).

Key considerations would include:

- How long ago was the DB transfer advice provided, and thus how realistic is the planned retirement age. It may be reasonable to assume that the more recent the advice, the more likely that the planned retirement age in the advice process accurately reflects their retirement plans.
- If the planned retirement age in the DB advice process differs to the age that the consumer entered drawdown in the DC scheme, what approach should be undertaken?
- Consideration is also required in respect of whether the planned retirement age as part of the DB advice was realistic/ appropriate (noting that the consumer has transferred due to unsuitable advice).

Other considerations

If no response is received from a consumer, then an option would be to allow the Redress Provider to make certain default assumptions (which may not be fully in the best interest of the consumer). It will be important that all assumptions made are clearly communicated to the consumer.

If an 'indicators of retirement' approach is to be adopted to determine whether a case is calculated on an Actual Loss basis, the FCA should consider including example case studies which explain how the retirement age assumption could be determined. In particular, the weighting given to each indicator and the nature of the assessment.

Actual Loss

Conclusions: How should an 'Actual Loss' case be defined?

For cases where a consumer has purchased an annuity in the DC scheme, we consider it appropriate to determine that as their 'retirement' for redress purposes. Therefore the calculation of redress should be undertaken assuming the consumer retired at that date in the DB scheme (consistent with the current approach to Actual Loss cases).

For cases where a consumer has only accessed PCLS and not any income in the DC scheme, we would not typically expect it to be appropriate to determine that as their 'retirement' for redress purposes. If this is the case the calculation of redress should be undertaken assuming that the consumer has not yet retired (i.e. valuing the DB benefits on a Prospective Loss basis) unless there is other information supporting this retirement date.

In respect of all other cases (i.e. drawdown and full withdrawal), there are a range of possible approaches. Each has its own advantages and disadvantages and a balance needs to be struck between accuracy and practicality.

Whether a case is calculated on a Prospective Loss or Actual Loss basis can have a material impact on redress amounts. The guidance on determining what constitutes an Actual Loss case has not been updated since the Pension Review. There is therefore a need for clear guidance in respect of Actual Loss cases reflecting the changes to the pensions landscape since the Pensions Review including the introduction of freedom and choice from April 2015.

If an indicators of retirement approach is to be adopted, we consider that the redress methodology should set out:

- The starting assumption (e.g. that the consumer would retire in the DB scheme at the earliest age they can take benefits unreduced (i.e. consistent with Prospective Loss cases) regardless of when / how they accessed their benefits in the DC scheme);
- The nature of the test to deviate from the starting assumption (e.g. 'balance of probabilities' or 'clearly demonstrate');
- The indicators which should be considered when determining whether a case should be calculated on an Actual Loss basis;
- The relative weighting / importance that should be given to each indicator and the approach to adopt where there is contradictory information and/ or where a consumer will not provide information;
- The principles which should be followed when reaching a decision; and
- Example cases to demonstrate how the indicator approach would be adopted in practice.

We consider that it is ultimately an FCA policy decision in respect of the approach to be proposed and consulted on for Actual Loss.

Actual Loss

How should PCLS be allowed for?

At retirement, in DB schemes, consumers typically have the option to commute a proportion of their pension for a tax free cash lump sum, known as a Pension Commencement Lump Sum ("PCLS").

Experience shows that the majority of consumers take a PCLS from their DB schemes and the current redress methodology therefore makes an allowance for consumers to take a PCLS at retirement.

There are two key points to consider for Actual Loss cases:

- The approach to allow for PCLS (i.e. adjustment to post-retirement discount rate or DB scheme specific factors); and
- How much PCLS should it be assumed a consumer would take from the DB scheme

FG 17/9 states that the adjustment to the discount rate approach, may be modified to reflect actual pension commencement lump sum percentages for actual loss cases.

We are aware that across the market there are a range of approaches being adopted with the majority adopting actual DB scheme PCLS factors and assuming that HMRC maximum PCLS is taken. This approach is broadly consistent with the original Pension Review guidance.

The approach to be taken to allow for PCLS in Actual Loss cases will be driven by the conclusion reached on the assumed retirement age to be adopted.

For cases where the DB scheme benefits are being valued on a Prospective Loss basis (for example where the consumer has only accessed PCLS in the DC scheme and is not deemed to have 'retired'), then the approach to allow for PCLS should be consistent with the Prospective Loss approach (i.e. an adjustment to the post retirement discount rate).

For cases where the consumer is deemed to have 'retired' and thus the DB scheme benefits are being valued on an Actual Loss basis (for example where the consumer has purchased an annuity in the DC scheme) then we consider that PCLS should be allowed for based on actual DB scheme early retirement and PCLS factors at the assumed date of retirement.

This approach will better reflect the benefits the consumer would have received from the DB scheme. To create consistency of approach, the redress methodology would need to specify early retirement factors and PCLS factors to be adopted where it is not possible to obtain these from the DB scheme.

We consider that the redress methodology would need to make clear that early retirement factors and PCLS factors at the assumed date of retirement are key data items.

How much PCLS should it be assumed a consumer would take from the DB scheme?

Where the Prospective Loss approach is adopted (i.e. adjustment to the post retirement discount rate assumption) this is implicitly assuming that the consumer takes c25% of their benefits as a Pension Commencement Lump Sum.

Whilst this is a practical approach, in our experience consumers will rarely ever take precisely 25% of their pension from a DB scheme. They will either take the HMRC maximum of the underlying value or a fixed defined monetary amount (where they have a purpose for it).

Where the Actual Loss approach is adopted, allowance for PCLS is based on DB scheme specific factors (based on the assumed date of retirement), there are broadly two options for consideration:

- HMRC Maximum
- Same as taken in DC scheme

We understand that there are a range of approaches adopted across the market (with the majority assuming the HMRC maximum). The impact of each approach depends on the specific DB scheme PCLS factors, but typically the greater the amount of PCLS assumed to be taken, the lower the level of redress.

Actual Loss

How should PCLS be allowed for?

Typically, where consumers access their benefits in a DC environment (other than annuity purchase) they will always take the maximum amount of PCLS as this is the most tax efficient approach to withdraw funds. In addition, the amount of tax free cash available on transfer in a DC environment is typically higher than that available from the DB scheme. As a result we do not consider it appropriate to base the assumed amount of PCLS taken from the DB scheme on the amount taken from the DC scheme.

Where the consumer is assumed to have retired and thus the DB benefits are being valued on an Actual Loss basis, we consider that the redress methodology should state that consumers should be assumed to commute the HMRC maximum from the DB scheme (other than in the limited circumstances set out to the right).

The formula to calculate the HMRC maximum should be known and understood by suitably qualified individuals undertaking redress calculations and is set out below.

The amount of PCLS assumed to be taken from the DB scheme (HMRC maximum) would be calculated as:

$$\text{PCLS} = \frac{P \times 20 \times F}{20+(3 \times F)}$$

Where:

P = Pension at assumed retirement age

F = DB scheme PCLS Factor

The Residual Pension would be calculated as: $P - \frac{PCLS}{F}$

The order of commutation (by tranche) of DB pension should be based on the DB scheme approach. Where this is not known we consider a reasonable default assumption to be that pension is commuted proportionately across all tranches (excluding GMP).

Example 1

- Pension at assumed retirement age of 60: £5,000 p.a.
- DB Scheme PCLS Factor: 20

$$\text{PCLS} = \frac{£5{,}000 \times 20 \times 20}{20+(3 \times 20)} = \textbf{£25,000}$$

$$\text{Residual Pension} = £5{,}000 - \frac{£25{,}000}{20} = \textbf{£3,750}$$

There are certain circumstances where this approach should be deviated from. In particular:

- where a consumer purchased an annuity in the DC scheme and took a lower PCLS amount, the allowance for PCLS in the calculation should be modified to reflect the actual pension commencement lump sum amount taken.
- where the pension commencement lump sum was an additional benefit to the pension income in the DB scheme. In this scenario, no allowance should be made for cash commutation.
- where the consumer had an AVC fund or DC section within the DB scheme, where the DB scheme allowed the PCLS to be taken from those sources before commuting DB pension. In these circumstances, the amount of PCLS should be modified to reflect the amount the consumer would have taken from the DB scheme (assuming they would have taken the HMRC maximum in totality).

Actual Loss

Default PCLS Factors

We recommend that any update to the redress methodology makes clear that early retirement factors and PCLS factors at the date of 'retirement' are key data items for Actual Loss cases.

However, there will be circumstances where, despite the best efforts of the redress calculator, it is not possible to obtain the relevant information from the DB scheme and so defaults will be required.

Default PCLS Factors

Factors will vary across different DB schemes, reflecting the different pension benefits which are being commuted (in particular the level of increases the DB pension would have received) and the basis used to set the factor.

The analysis produced by the IFoA (as set out in detail in Section 5b (Assumptions: Post Retirement Discount Rate) of this Report) supports that the majority of DB scheme PCLS factors for a male at age 65 with a pension increasing in payment with RPI up to 5% p.a. are in the region of 16:1 – 20:1, however there is a wide range of factors adopted. These factors would have been set based on different dates (and reflect a number of different scheme specific considerations).

The analysis in Section 5b (Assumptions: Post Retirement Discount Rate) of this Report evidences that the Prospective Loss approach (of making an addition to the post-retirement discount rate) is broadly equivalent to a PCLS factor in the range of 20.5 to 26.0 for a male at age 65 with a pension increasing in payment with RPI up to 5% p.a.

There is a gradual trend of PCLS factors in DB schemes increasing over time. Prospective Loss cases are considering what PCLS factors will be at some point in the future when a consumer reaches retirement, whereas Actual Loss cases are considering what PCLS factors are in the past when a consumer is assumed to have retired. Therefore, we considered it reasonable for the default Actual Loss PCLS factor to be lower than the PCLS factor implied by the Prospective Loss approach.

Whilst PCLS factors should vary based on the consumer's date of retirement and the level of pension increases that apply, we consider that it would provide practical challenges to specify default PCLS factors for all retirement ages and benefit types. Therefore we consider the adoption of a single default PCLS factor to be a pragmatic approach.

Based on the analysis of PCLS factors and your objectives, we consider that a default PCLS factor of 20 is a reasonable assumption to adopt for Actual Loss cases where the PCLS factor is unknown.

Actual Loss

Default Early and Late Retirement Factors

Default early retirement factors

Under the Pensions Review (SIB Simplifying the Pensions Review Schedules to Part 2), the default Early retirement factor was 6% p.a. compound applied to the pension revalued to the early retirement age.

There is limited publicly available information in respect of the level of early retirement factors adopted by DB pension schemes. The factors will vary across different DB schemes, reflecting the different pension benefits which are being valued (in particular the level of increases the DB pension would have received) and the basis used to set the factor.

In our experience there has been a gradual reduction in the level of early retirement factors in DB schemes over recent years due to strengthening actuarial bases (linked to the Pensions Regulator's actions to improving funding levels) and lower gilt yields. We would typically expect early retirement factors in DB scheme to range from 3% p.a. to 5% p.a.

For reference, under the current FG 17/9 Guidance, based on market conditions at 31 March 2022, cost neutral early retirement factors applied to the pension revalued to the early retirement age (for an individual retiring at age 60 with a normal retirement age of 65) and respective pension increases in payment are broadly:

Nil Increases	LPI5 increases
3%	4%

We consider that a default early retirement factor of 4% p.a. compound (applied to the pension revalued to early retirement age) is a reasonable assumption to adopt where the factors are unknown.

Default late retirement factors

Typically we would expect consumers in DC schemes to often access benefits before the DB scheme's normal retirement date rather than after. However, there will be instances where late retirement factors are required (including when valuing Barber tranches).

We consider that the default late retirement factor should be actuarially consistent with the default early retirement factor.

Based on this, we consider a default late retirement factor of 5% p.a. compound (applied to the pension revalued to late retirement age) is a reasonable assumption to adopt where the factors are unknown.

Discounted Mean Terms for Actual Loss cases

Section 5b (Assumptions: Post Retirement Discount Rate) of this Report sets out Discounted Mean Terms ('DMT') for use in the derivation of the post retirement discount rate assumption and the post retirement inflation assumption.

Assumed retirement age	55	60	65	70	75
DMT	23	20	16	13	11

We consider that the redress methodology should explicitly state that for Actual Loss cases, the DMT to adopt to derive the assumptions to value the Future Loss should be based on the consumer's age at the Date of Calculation. We understand that this is consistent with the approach currently adopted by redress calculator software providers.

Where a consumer is in-between these ages, the DMT should be based on linear interpolation and rounded to the nearest integer.

Actual Loss

Other considerations

How should past payments be revalued?

An Actual Loss redress calculation has two parts:

- Past Loss: Relating to the actual loss in benefits received between date of 'retirement' and Date of Calculation
- Future Loss: Relating to the theoretical loss in benefits post Date of Calculation

The past payments received by the consumer prior to the Date of Calculation need to be increased from date of payment to Date of Calculation at an appropriate rate. The interest rate at which past payments should be 'rolled up' is not directly commented on in the FG 17/9 Guidance.

We understand from the FCA that a variety of approaches are being adopted across the industry, including: base rate, base rate + 1%, and 8% simple. Other options including an inflation linked assumption could be considered.

The original SIB guidance in the Pension Review states that past payments should be increased "using a suitable UK clearing bank base rate for the relevant period".

Based on your objectives, we consider that past payments (both relating to the DB scheme and the DC scheme) should be increased from date of payment to Date of Calculation in line with Bank of England Base Rate over the period.

There will be circumstances where a consumer has accessed benefits in the DC scheme, but the DB benefits are not being valued on an Actual Loss basis (for example where a consumer has not been assumed to have retired).

In this scenario we consider that past payments relating to the DC scheme should be increased from date of payment to Date of Calculation in line with Bank of England Base Rate over the period and added on to the DC fund value at Date of Calculation.

This provides consistency with how these payments would be treated where the DB scheme benefits are being valued on an Actual Loss basis.

We note that clarification could be provided by the FCA on how past payments should be rolled up (i.e. using simple gross payments or considering the net income received). Consideration of the tax treatment of redress is outside the scope of our review. The FCA will need to consider whether to include this as part of the consultation alongside the extent to which the FCA wishes to comment on tax treatment in the redress methodology.

Loss assessment at 'retirement' date?

Under the original SIB guidance as part of the Pension Review, for Actual Loss cases, a calculation is undertaken at 'retirement' based on market conditions at the time, to determine whether there has been a loss. If there is no loss then no further action is required. If there is a loss then a redress calculation is undertaken at the current date.

This approach was considered appropriate at the time of the Pension Review given the majority of consumers purchased an annuity at retirement. Therefore if they bought an annuity at retirement of an equivalent or greater value than the DB scheme benefits (at that time), then it would be reasonable for no redress calculation to be undertaken.

In the current pensions environment, with the majority of consumers not purchasing an annuity at retirement it is no longer considered appropriate to undertake the loss assessment at date of 'retirement'. We consider that all calculations should be undertaken as a redress calculation at the Date of Calculation (rather than a loss assessment first at the date of 'retirement').

Actual Loss

Other considerations

How should redress for Actual Loss cases be paid?

For Actual Loss cases, consideration could be given to purchasing an annuity for the consumer to replicate the DB benefits rather than providing a lump sum of the actuarial equivalent value.

We understand that there are circumstances where the cost of actually purchasing an annuity can be lower than that produced by the current redress guidance. Whilst our review of the post retirement redress assumptions is seeking to derive a DB value to replicate the cost of purchasing the benefits in the open market, as it is a 'general' approach, it will naturally lead to over and under compensating in different scenarios.

It could be considered that providing a lump sum as redress gives consumers the additional benefit of retaining flexibility (i.e. over compensates) and that if the offer of redress was only to purchase an annuity, then some consumers may reject redress as they would rather retain the flexibility they currently have.

Whilst immediate annuity purchase would in theory put the consumer back in the position they would have been but for the unsuitable advice, it does raise a number of practical challenges. In particular:

- Immediate annuities are more attainable in the market than deferred annuities (making this approach more realistic for Actual Loss cases compared to Prospective Loss cases). However, there will be cases where it is not possible to purchase an annuity to exactly replicate the DB scheme benefit structure.
- Legal advice would be required to determine if it would be possible to 'force' the consumer to use their existing fund (along with the redress) to purchase an annuity.
- Where a consumer has entered drawdown and withdrawn a proportion of their fund, consideration would be required as to what size/ form of annuity would be required to be purchased and how this would be determined. There will be scenarios where the consumer will have withdrawn more funds than the historic DB past payments and therefore there will not be sufficient funds remaining to buy an annuity to exactly replicate the future DB benefits.
- Where an annuity cannot be obtained to replicate DB scheme benefits, if the alternative would be to pay redress as a cash lump sum this would create a two-tier system.

Impaired Lives

In response to the 2017 Consultation a number of respondents raised the issue of impaired lives. Respondents put forward the view that where a consumer would be eligible for an impaired life annuity, the current redress methodology (which makes no allowance for impaired life expectancy) would materially over-compensate the consumer.

Whilst we would agree with this sentiment, there are practical challenges of adapting the redress methodology to allow for impaired life expectancies and there would be a requirement for additional data gathering from the consumer.

> We consider that this is a policy decision for the FCA. We consider that the consultation should cover this potential approach to redress of annuity purchase for Actual Loss cases, (including impaired life annuities) and the practical challenges associated with it.

Actual Loss

Overall Conclusions

Overall we propose that a number of amendments are made to the approach to Actual Loss calculations and for greater information be provided in the redress methodology in relation to the approach to Actual Loss redress calculations.

Current approach

Assumed retirement age: Actual loss cases occur where the customer has retired, died, or both.

Approach to allowance for PCLS: The final rate (post retirement discount rate) adjusts for the pension commencement lump sum by taking:

- 75% of the initial rate, plus
- 25% of the initial rate plus 1.6%

This may be modified to reflect actual pension commencement lump sum percentages for actual loss cases or where the pension commencement lump sum was additional to pension income in the original scheme.

Marital Status: The actual marital status at date of crystallisation should be used, if known.

For Consultation

Tax treatment of past payments: Clarification should be given on how past payments should be rolled up. Consideration of the tax treatment of redress is outside the scope of our review. The FCA will need to consider whether to include this as part of the consultation alongside the extent to which FCA wishes to comment on tax treatment in the redress methodology.

Indicators of Actual Loss: We consider that it is ultimately an FCA policy decision in respect of the approach to be proposed and consulted on for drawdown cases and in respect of indicators of Actual Loss.

Redress through annuity purchase and impaired lives: We consider that the consultation should cover this potential approach to redress of annuity purchase for Actual Loss cases, (including impaired life annuities) and the practical challenges associated with it to seek respondents views.

Proposed approach

Discounted Mean Term (DMT): For Actual Loss cases, the DMT to adopt to derive the assumptions to value the Future Loss should be based on the consumer's age at the Date of Calculation. Where a consumer is in-between the ages of the DMT's provided, the DMT should be based on linear interpolation and rounded to the nearest integer.

Marital/Civil Partnership Status: The actual marital/civil partnership status at Date of Calculation should be used, if known.

Past Payments (Past Loss): Past payments (both relating to the DB scheme and the DC scheme) should be increased from date of payment to Date of Calculation in line with Bank of England Base Rate over the period.

Default Early and Late Retirement Factors: Early and Late retirement factors at the date of 'retirement' are a key data item for Actual Loss cases and every attempt should be made to obtain them. Where it is not possible to obtain the relevant information a default Early retirement factor of 4% p.a. compound and a default Late retirement factor of 5% p.a. compound should be adopted. These factors should be applied to the pension revalued to early/ late retirement date.

Actual Loss

Overall Conclusions

Proposed approach (continued)

Approach to allow for PCLS: For cases where the consumer is deemed to have 'retired' and thus the DB scheme benefits are being valued on an Actual Loss basis, PCLS should be allowed for based on actual DB scheme PCLS factors at the assumed date of retirement. It should be assumed that the consumer would commute the HMRC maximum other than in the following scenarios:

- where a consumer purchased an annuity in the DC scheme and took a lower PCLS amount, the allowance for PCLS in the calculation should be modified to reflect the actual pension commencement lump sum amount taken.
- where the pension commencement lump sum was an additional benefit to the pension income in the DB scheme. In this scenario, no allowance should be made for cash commutation.
- where the consumer had an AVC fund or DC section within the DB scheme, where the DB scheme allowed the PCLS to be taken from those sources before commuting DB pension. In these circumstances, the amount of PCLS should be modified to reflect the amount the consumer would have taken from the DB scheme (assuming they would have taken the HMRC maximum in totality).

Where it is not possible to obtain the relevant information, a default PCLS factor of 20 should be adopted.

Actual Loss

Future review

Future review

The changes proposed to the approach to Actual Loss cases and the additional clarity proposed for the redress methodology will enable the approach to better reflect the current pensions environment and improve consistency of approach across the market.

We consider that a review of the default assumptions (i.e. PCLS, Early Retirement and Late Retirement) should be undertaken on a four yearly basis to make sure they remain appropriate relative to DB scheme practices.

7. The SERPS adjustment

SERPS adjustment

Background to the SERPS adjustment

The SERPS adjustment

Based on documentation from the Pension Review[1] and FSA Pension Review Bulletins 8 and 10, an adjustment has historically been made to redress calculations to allow for the impact that transferring/opting out of the original DB scheme would have had on the individual's State Pension entitlement. This was referred to as 'the SERPS adjustment'. It was acknowledged at the time that this was a simplified general approach.

The principles behind the SERPS adjustment are as follows:

- For cases where an individual transfers out of a contracted out DB scheme:
  - The revaluation applied to a part of their State Pension entitlement known as the contracted out deduction (or "COD") (i.e. the deduction to the full State Pension entitlement to allow for contracted out service) from date of leaving the DB scheme to State Pension Age ("SPA") would differ as a result of the transfer.
  - Prior to the transfer, the revaluation would be based on the GMP revaluation used in the DB scheme (either Fixed Rate revaluation or Section 148 Orders).
  - Once the transfer has taken place, the revaluation would instead typically be based on:
    - S148 orders – for transfers to personal pensions
    - Fixed Rate revaluation – for transfers to Section 32 policies
  - As such, where the revaluation approach differs pre/post transfer, there would be a difference in how the COD is revalued, and thus a difference in the individual's State Pension entitlement.
- For cases where an individual opts-out of a contracted out DB scheme:
  - The above revaluation points may also apply to opt-out cases.
  - The individual's contracted out service may differ as a result of opting-out of the DB scheme, and so the amount of GMP (and thus COD) the individual accrued in the DB scheme would also differ. Therefore the resulting State Pension (after the COD deduction) would also differ.

In both cases, the SERPS adjustment effectively requires the redress calculator to value the difference in the consumer's State Pension entitlement at SPA assuming that the transfer/opt-out never took place, and the consumer's actual State Pension entitlement. This is used to either increase or decrease the redress payable.

The impact

Whether the SERPS adjustment increases or decreases redress depends on the specific circumstances of the consumer and their DB scheme, but typically:

	Transfer to a Personal Pension	**Transfer to a Section 32 policy (with fixed rate revaluation)**
Transfer from a DB scheme with Fixed Rate GMP Revaluation	Reduction in redress	No Impact
Transfer from a DB scheme with s148 GMP Revaluation	No Impact	Increase in redress

The approach to allow for a SERPS adjustment in redress calculations has not been updated since the original Pension Review guidance.

[1] *Pension Opt-Outs and Non-Joiners (April) and Transfers (July): Guidance For Review Of Past Business, dated 1995, as issued by PIA.*

SERPS adjustment

Background to the SERPS adjustment

The current FG 17/9 Guidance states that "*a firm will need to consider if and how the State Earnings Related Pension Scheme (SERPS) adjustment should be applied in the particular circumstances of the case to ensure that appropriate redress is offered to the complainant*".

In our view, the approach set out in the Pension Review guidance is no longer appropriate given the changes to Fixed Rate GMP Revaluation Rates, the time that has elapsed since the Pension Review SERPS adjustment methodology was devised, and the changes to State Pension introduced from 6 April 2016.

- In our experience, applying the existing SERPS adjustment to redress cases can result in SERPS adjustments which materially overstate the impact. This is particularly prevalent for consumers who left DB schemes (which were contracted out on a Fixed Rate GMP revaluation basis) between 6 April 1978 and 5 April 2002 and thus whose GMP in the DB scheme (and COD) would have been subject to revaluation at a fixed rate of between 6.25% p.a. and 8.5% p.a.
- The majority of future redress claims are expected to relate to transfers to personal pensions rather than Section 32 policies. Therefore where Redress Providers continue to apply the current SERPS adjustment methodology it is likely to result in too large a SERPS adjustment and thus redress to consumers being understated.

If an allowance for a SERPS adjustment is to be retained within the redress methodology, in order to meet the FCA's objectives we consider that it is necessary to apply different approaches to calculating a SERPS adjustment depending on when the consumer reaches SPA and when the consumer transferred/opted-out (specifically whether it is before or after 6 April 2016).

Table of Fixed Rate GMP Revaluation Rates

Date of leaving contracted out DB scheme	Fixed Rate of Revaluation (p.a.)
6 April 2022 - 5 April 2027	3.25%
6 April 2017 - 5 April 2022	3.5%
6 April 2012 - 5 April 2017	4.75%
6 April 2007 - 5 April 2012	4.0%
6 April 2002 - 5 April 2007	4.5%
6 April 1997 - 5 April 2002	6.25%
6 April 1993 - 5 April 1997	7.0%
6 April 1988 - 5 April 1993	7.5%
before 6 April 1988	8.5%

SERPS adjustment

Proposed approach

Individuals who reach SPA after 6 April 2016 will receive the New State Pension when they reach SPA. As such, DWP will have calculated a 'starting amount' for their State Pension in 2016.

Transfer/opt-out post 6 April 2016

The DWP has confirmed that the 'starting amount' will not change if the individual transfers out of a DB scheme.

Based on this, our understanding is that the calculation of the 'starting amount' (undertaken as at 6 April 2016) is not revisited if a consumer transfers out (or opts out) of a DB scheme and as such, the consumer's State Pension entitlement does not change as a result of the transfer (or opt-out).

In this scenario, there is no requirement for a SERPS adjustment as there is no impact on the consumer's state pension entitlement.

Therefore, to best meet the FCA's objectives, we propose that the redress methodology states that no SERPS adjustment is made in redress calculations for consumers who have transferred or opted-out post 6 April 2016.

Given that there is no SERPS adjustment applicable to transfers post 6 April 2016, the volume of redress cases which are potentially impacted by the SERPS adjustment will decrease over time. However, we are aware that there will still be a number of redress calculations required in the market relating to transfers/ opt outs pre 6 April 2016 and thus the redress methodology should provide clarification on the approach to be adopted for these cases. This is particularly important given the risk of the current SERPS adjustment methodology under-compensating consumers.

Transfer/opt-out pre 6 April 2016

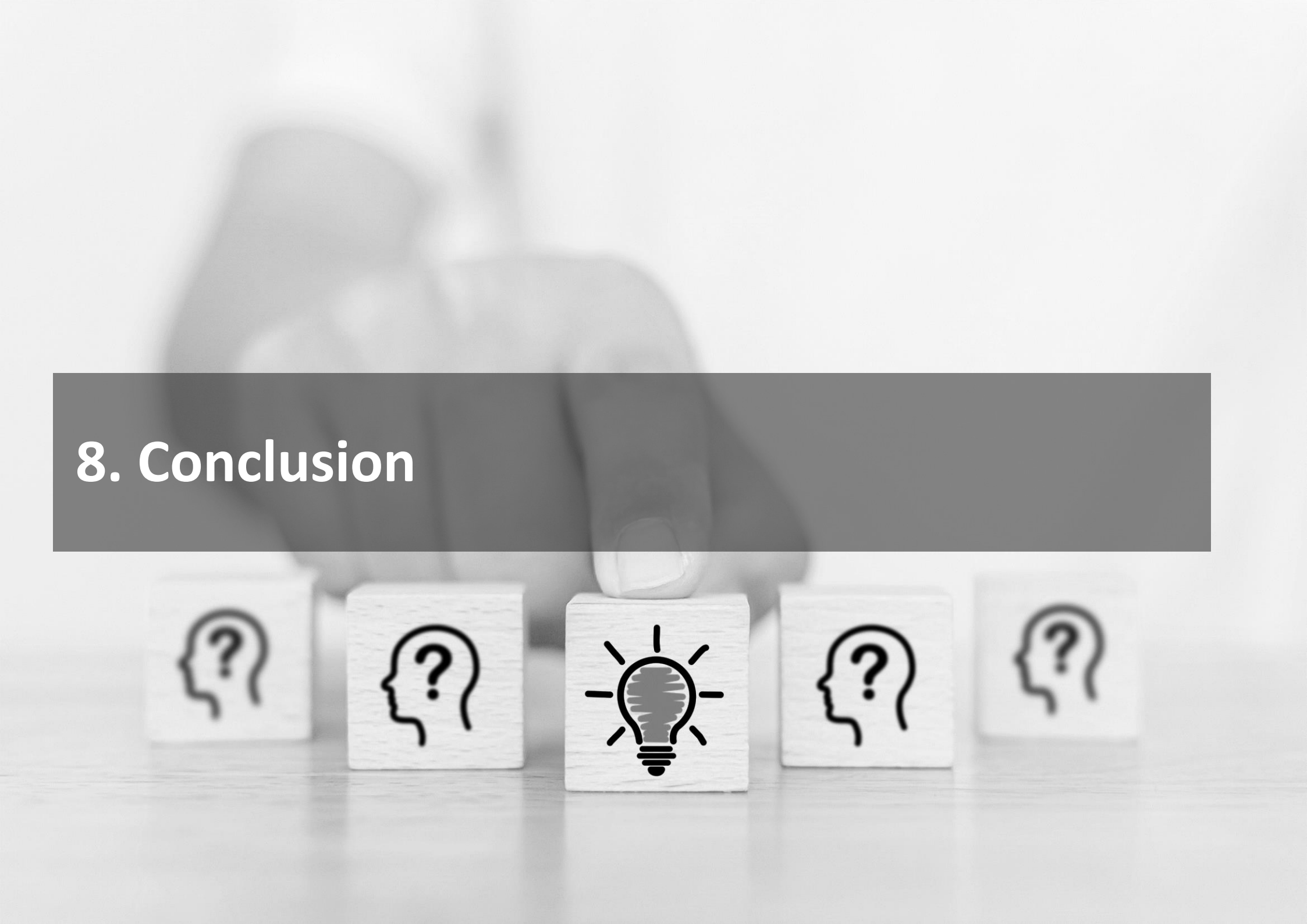
Where the transfer/opt-out occurred before the calculation of the 'starting amount' took place (i.e. 6 April 2016), our understanding is that the starting amount calculated would have differed depending on whether the transfer/opt-out took place (due to how the COD would have revalued).

Assuming that the 'starting amount' (and therefore the resulting State Pension at SPA) would differ as a result of transferring/opting-out, it is considered appropriate for redress calculations to include an adjustment to allow for the impact of the transfer/opt out on the individual's State Pension entitlement.

Due to the complexities of the calculation of the starting amount and the individual nature of the State Pension entitlement, we consider that it would be necessary for the redress calculator to obtain detailed information on the individual's State Pension calculation from DWP to enable them to accurately calculate the impact on the State Pension of the transfer/opt-out. We do not consider it appropriate to retain the current SERPS adjustment methodology or to apply a general industry standard approach.

We are aware that some Redress Providers are already requesting and receiving this information from the DWP when undertaking redress calculations.

8. Conclusion



Conclusion

Proposed approach

Proposed approach

Based on the FCA's objectives, we propose that the FCA retains the existing approach of calculating redress as a lump sum which represents the difference between the capitalised value of the benefits the consumer would have received from the DB scheme (had they not transferred, opted-out or non-joined) to the value of the funds in the DC scheme.

Where it is possible to pay redress into a consumer's DC pension and not be impacted by tax issues (relating to Annual Allowance, Lifetime Allowance and/or Gross Earnings), we consider this the most appropriate approach.

However, it is acknowledged that this will not be possible in all redress cases. In these cases, we propose that the redress should be paid as a cash amount to the consumer. This is consistent with the current approach.

Consideration of the tax implications of the payment of redress (either into a personal pension or as a cash lump sum) are excluded from the scope of our work. However, the FCA may wish to obtain specialist tax advice in respect of this for inclusion as part of the consultation.

Throughout this Report we have made a number of proposals in respect of changes to various aspects of the redress methodology. The intention of the proposed changes is to deliver a redress methodology which better meets the FCA's stated objectives.

The Technical Manual published alongside this Report has been prepared to provide worked examples of the redress calculation process for transfers under the proposed redress methodology as set out in the FCA's Consultation Paper CP22/15. **The content of the Technical Manual is solely based on the FCA's proposed redress methodology set out in the FCA's Consultation Paper CP22/15, the contents of which may differ to the information contained in this Report.**

Additional information

On the following pages we provide a summary of:

- The proposals for each of the areas covered in this Report;
- Additional disclosures that we consider should be made to consumers as part of the redress offer process. These are designed to provide the consumer with sufficient information to understand the assumptions underpinning the redress offer; and
- Calculations showing the impact of calculating redress under the current methodology compared to the proposed changes for eight example consumers.

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Current approach	Proposed approach
Assumption: RPI Inflation	Based on the 'UK instantaneous implied inflation forward curve (gilts)' published by the Bank of England to 40 years. This curve is then extrapolated for any term exceeding 40 years, using the average difference between inflation and gilt yield curves over the terms 35 to 39 years. For any term shorter than 3 years, the 3 year rate is assumed to apply. The RPI Inflation rate for pre- and post-retirement is derived as follows: • Pre-retirement – take the spot rate for the term to retirement • Post-retirement – take the derived forward rates from normal retirement age to the age indicated after adding on the discounted mean term, using the same methodology as the guidance states in relation to the post-retirement discount rate. The final assumptions should then be rounded to the nearest 0.05%	Based on the 'UK instantaneous implied inflation forward curve (gilts)' published by the Bank of England to 40 years. For terms greater than 40 years, the 40 years rate should be used. For terms shorter than that published, the next available rate should be adopted. This includes the use of the 2.5 year term rates rather than 'stepping over' this to the 3 year rate. • Pre-retirement – take the spot rate for the term to retirement (specifically, the number of integer years to retirement). A deduction of 0.2% should be made for an Inflation Risk Premium. • Post-retirement – take the derived forward rates from assumed retirement age to the age indicated after adding on the discounted mean term, using the same methodology as the guidance states in relation to the post-retirement discount rate. The final assumptions should then be rounded to the nearest 0.05%. Note, where the RPI rate is used in the derivation of other assumptions (including CPI, pension increases and pre-retirement discount rate), the unrounded RPI rate should be used.

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Current approach	Proposed approach
Assumption: CPI Inflation Pre Retirement	For any redress calculations before 1 January 2021, the CPI Inflation rate is assumed to be RPI Inflation minus 1%. For all other calculations, the pre- and post-retirement CPI Inflation assumption for common assumed retirement ages is provided in Annex 1 of the guidance. For any retirement ages in the range 55-75 not listed in the table provided, linear interpolation should be used to derive these. Furthermore, for any ages less than 55, or greater than 75, linear extrapolation should be used for derivation of an appropriate rate.	• For calculations with an effective date in year 20YY • For a consumer with term to retirement of x years where 0 < a ≤ x < b (with a and b the integer values either side of x) The RPI - CPI gap for pre-retirement inflation (deferred revaluation): **If 20YY + a ≤ 2030: = 1%** $$\boldsymbol{Else} = \frac{[\mathbf{1}\% \times (\mathbf{2030} - \mathbf{20YY})] + \mathbf{0.5}\%}{\boldsymbol{a}}$$ The (unrounded) RPI - CPI gap for pre-retirement inflation should be applied to the relevant unrounded RPI rate. The final CPI assumption should then be rounded to the nearest 0.05% at the end.
Assumption: CPI Inflation Post Retirement	For any redress calculations before 1 January 2021, the CPI Inflation rate is assumed to be RPI Inflation minus 1%. For all other calculations, the pre- and post-retirement CPI Inflation assumption for common assumed retirement ages is provided in Annex 1 of the guidance. For any retirement ages in the range 55-75 not listed in the table provided, linear interpolation should be used to derive these. Furthermore, for any ages less than 55, or greater than 75, linear extrapolation should be used for derivation of an appropriate rate.	• For calculations with an effective date in year 20YY • For a consumer with term to retirement of x years where a ≤ x < b (with a and b the integer values either side of x) • For a consumer retiring at an age with associated DMT = d RPI - CPI gap for post-retirement inflation (pension increases): **If 20YY + a > 2030: 0%** $$\boldsymbol{Else} = \frac{[\mathbf{1}\% \times (\mathbf{2030} - \mathbf{20YY} - \boldsymbol{a})] + \mathbf{0.5}\%}{\boldsymbol{d}}$$ The (unrounded) RPI - CPI gap for pre-retirement inflation should be applied to the relevant unrounded RPI rate. The final CPI assumption should then be rounded to the nearest 0.05% at the end.

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Current approach	Proposed approach
Assumption: Pension Increases in payment	This is defined as the relevant pension increase assumption together with the either the RPI or CPI assumption (depending on the rules of the relevant DB Scheme) • **If the scheme rules impose a cap:** The cap specified by the rules should be used where the relevant inflation assumption is higher than the cap, and the relevant inflation assumption should be used where it is below the cap. • **If the scheme rules impose a floor:** The floor specified by the rules should be used where the relevant inflation assumption is lower than the floor, and the relevant inflation assumption should be used where it is above the floor. • If the scheme grants fixed increases in payment, then those fixed rates should be used.	This is defined as the relevant pension increase assumption together with either the RPI or CPI assumption (depending on the benefits of the relevant DB Scheme). • If the scheme imposes a cap and/ or a floor: The pension increase assumption should be derived using a standard Black's model with an inflation volatility of 1.0%. The final assumption should be rounded to the nearest 0.05%. • If the scheme grants fixed increases in payment, then those fixed rates should be used.

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Current and Proposed approach
Assumption: Post-Retirement Discount Rate	The 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 integer term to retirement and the discounted mean term, 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 integer term 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. An adjustment is also made to the post-retirement discount rate assumption to allow for the option for the consumer to take a pension commencement lump sum. 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%. This may be modified to reflect actual pension commencement lump sum percentages for Actual Loss cases or where the pension commencement lump sum was additional to pension income in the original scheme. The discounted mean term is dependent on the assumed retirement age as follows: **Assumed retirement age** 55 60 65 70 75 **DMT** 23 20 16 13 11 Discounted mean terms for other assumed retirement ages should be based on linear interpolation and rounded to the nearest integer.

Conclusion

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Current approach	Proposed approach
Assumption: Pre-Retirement Discount Rate	The pre-retirement discount rate is derived as one half of the expected return on equities. The expected return on equity for the period to retirement is: (1 + RPI spot inflation rate) x (1+ dividend yield) x (1 + growth in dividends) -1 Prospective long-term real dividend growth is assumed to be 0.5% per year, with dividend yields being taken from the FTSE All Share Index on the last business day of the quarter. The period to retirement is the number of integer years remaining to assumed retirement age. The final assumptions should then be rounded to the nearest 0.05%	The pre-retirement discount rate is derived as one half of the expected return on equities. The expected return on equity for the period to retirement is: **(1 + CPI spot inflation rate) x (1+ average dividend yield) x (1 + growth in dividends) - 1** The period to retirement should be taken as the number of integer years remaining to assumed retirement age Where: • CPI spot inflation is derived in line with the (unrounded) approach for setting the CPI assumption • Average dividend yield = The arithmetic average of the dividend yield on the FTSE All Share Index of the last business day over the last four quarter ends. • Growth in dividends = Fixed 1% p.a. The final assumptions should then be rounded to the nearest 0.05%
Assumption: Retirement Age	The earliest age at which the consumer could have retired from the DB Pension Scheme without both: • Requiring the consent of the employer; and • Suffering a reduction in benefits Where a consumer has benefits payable from different ages, the redress calculation should reflect the most favourable option for the consumer.	The earliest age at which the consumer could have retired from the DB Pension Scheme without both: • Requiring the consent of the employer; and • Suffering a reduction in benefits Where a consumer has benefits payable from different ages, the redress calculation should reflect the most favourable option for the consumer.

Conclusion

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Current approach	Proposed approach
Assumption: Mortality	Base Table - 100% of the PxA08 tables, published by the Institute & Faculty of Actuaries (IFoA) Continuous Mortality Investigation, assuming male and female mortality in equal parts. Future Improvements – Calculated using 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.	Base Table - 100% of the PxA16 tables, published by the Institute & Faculty of Actuaries (IFoA) Continuous Mortality Investigation, assuming male and female mortality in equal parts. Future Improvements – Calculated using 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. Allowance should be made for pre-retirement mortality, with a corresponding allowance for the death before retirement benefits provided by the DB scheme, based on the above mortality assumptions.
Assumption: Spouse/ Civil Partner's Age Difference	Where known, the actual age of a consumer's spouse should be used, otherwise the spouse is considered to be the same age as the consumer.	The actual age of a consumer's spouse/civil partner should be requested and used where possible, otherwise the spouse/civil partner should be considered to be the same age as the consumer.

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

<table>
<tr><th>Area of consideration</th><th>Current approach</th><th>Proposed approach</th></tr>
<tr><td>Assumption: Proportion married or in a civil partnership</td><td>It should be assumed that 85% of consumers will be married at retirement.

For actual loss cases, the actual marital status at date of crystallisation should be used, if known.</td><td>For Prospective Loss cases, the table below should be used for the proportion married/in a civil partnership based on the actual marital/partnership status of the consumer.
<table>
<tr><th>Term to retirement</th><th>Married/In civil partnership</th><th>Not Married/Not in civil partnership</th></tr>
<tr><td>0</td><td>100%</td><td>0%</td></tr>
<tr><td>5</td><td>95%</td><td>10%</td></tr>
<tr><td>10</td><td>90%</td><td>20%</td></tr>
<tr><td>15</td><td>85%</td><td>30%</td></tr>
<tr><td>20</td><td>80%</td><td>40%</td></tr>
<tr><td>25</td><td>75%</td><td>45%</td></tr>
<tr><td>30</td><td>70%</td><td>50%</td></tr>
<tr><td>35</td><td>70%</td><td>55%</td></tr>
<tr><td>40</td><td>70%</td><td>55%</td></tr>
</table>
Rates should be interpolated for other terms and rounded to the nearest 1%. No adjustment should be applied for mortality of the spouse/partner before application.

For Actual Loss cases, the actual marital/partnership status at Date of Calculation should be used, if known.</td></tr>
</table>

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Current approach	Proposed approach
Assumption: Charges	**Personal Pension Charges:** The personal pension charges, where known, should be deducted from the pre-retirement discount rate up to a maximum of 0.75% per year. Where the charges are not known or are structured differently, the calculation should result in a figure which is no greater than a deduction of 0.75% per year from the pre-retirement discount rate for personal pension charges. **Non percentage charges:** Where firms use any other method to take account of future product and ongoing adviser charges, e.g. for non-percentage-based charges, they should satisfy themselves that the result achieves the same intent. **Adviser Charges:** Regular adviser charges should be assumed to continue in full, at the current level. The regular adviser charges should be deducted from the pre-retirement discount rate.	Allowance for charges should be made by 'netting down' the pre-retirement discount rate. This would be undertaken as follows: • Pre-retirement discount rate (unadjusted for charges): i% p.a. • Charges: c% p.a. **Pre-retirement discount rate (adjusted for charges):** [(1+i%) * (1-c%)] – 1 **Personal Pension Charges:** The personal pension charges, where known, should be 'netted off' the pre-retirement discount rate. Where the charges are not known, personal pension charges should be assumed to be 0.75% per year. **Non percentage charges:** Where non percentage charges apply, the net present value of these fixed monetary charges (in the period from Date of Calculation to assumed retirement age) should be calculated based on the pre-retirement discount rate prior to any charges adjustment. This amount should then be added to the redress amount. Where firms use any other method to take account of future product and ongoing adviser charges, they should satisfy themselves that the result achieves the same intent. **Adviser Charges:** Regular adviser charges should be assumed to continue in full, at the current level. The regular adviser charges should be 'netted off' from the pre-retirement discount rate.

Conclusion

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Current approach	Proposed approach
Methodology: Assumption update frequency	Assumptions used in the calculation of redress should be updated quarterly.	Assumptions used in the calculation of redress should be updated quarterly.
Methodology: Calculation Date	Redress calculations must be based on the new assumptions from the first business day of each new quarter, using publicly available data based on the final business day of the quarter just ended.	The Date of Calculation should be the first business day of the quarter (for calculations undertaken within the quarter). Redress calculations must be based on the new assumptions from the first business day of each new quarter, using publicly available data based on the final business day of the quarter just ended.
Methodology: Period of validity	Calculations made under this guidance will remain valid for three months from date of issue to the consumer, irrespective of quarterly changes to the assumptions.	Calculations made under this guidance will remain valid for three months from date of issue to the consumer, irrespective of quarterly changes to the assumptions.
Methodology: Interest on redress	*No explicit wording in the current* FG 17/9 *Guidance*	Interest should be applied to the redress amount calculated for the period from Date of Calculation to date of settlement. • For Prospective Loss cases, interest should be applied in line with the pre-retirement discount rate assumption (with an adjustment for charges) • For Actual Loss cases: interest should be applied in line with the post-retirement discount rate assumption (with no adjustment for annuity pricing nor PCLS)

Conclusion

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Current approach	Proposed approach
Methodology: Earnings Growth	*No explicit wording in the current FG 17/9 Guidance*	An assumption for future earnings growth (used for both S148 orders and salary growth for opt-out/non-joiner cases) of CPI + 1.0% p.a. should be adopted.
Methodology: Enhanced Transfer Values:	Where a cash enhancement was paid in addition to the transfer value, the cash enhancement should be rolled up from the date of payment to the calculation date using 50% of the return on the FTSE100 Total Return Index. This should be net of personal pension charges for each year, as determined previously, and the figure added to the value of the consumer's personal pension policy.	Where a cash enhancement was paid in addition to the transfer value, the cash enhancement should be rolled up from the date of payment to the calculation date using 50% of the return on the FTSE100 Total Return Index. This should be net of personal pension charges for each year, as determined previously, and the figure added to the value of the consumer's personal pension policy.
Methodology: FSAVCs	FSAVC Review Model Guidance states that the CAPS 'Mixed With Property' Fund should be used as a benchmark index for modelling fund performance.	The benchmark index used for fund performance in FSAVC redress calculations should be: • The CAPS 'Mixed With Property' Fund up to 1 January 2005; and • The FTSE UK Private Investor Growth Total Return Index post 1 January 2005.
Methodology: DC values	n/a	Where an up-to-date DC value is not available at the Date of Calculation: • Market related assets: where there is a price of the underlying fund(s) available: A notional value of the DC fund at the Date of Calculation should be determined based on the movement of the fund using the underlying fund price (and allowing for known charges). • Illiquid/ unquoted assets: The value adopted should be the latest available valuation increased in line with actual CPI inflation from the latest available valuation date to the Date of Calculation unless there is clear evidence to that the value has otherwise moved materially.

Conclusion

Proposed changes

The table below and on the following pages summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Current approach	Proposed approach
Methodology: Pension Protection Fund (PPF)	A respondent should consider how far they should take into account any adjustment to the benefits which the consumer would have been eligible for under the DB scheme including the scheme entering the Pension Protection Fund.	Where the original DB scheme is already in the PPF, the DB scheme benefits should be valued in line with PPF benefits. When a scheme is in the Assessment Period for the PPF, the DB scheme benefits should be valued in line with PPF benefits unless there is knowledge that the scheme is shortly going to be secured outside of the PPF and consumers receive higher benefits.
Methodology: PCLS and separate lump sums	The PCLS adjustment may be modified to reflect where the PCLS was additional to pension income in the original scheme	Where the pension commencement lump sum was an additional benefit to the pension income in the DB scheme no allowance should be made for cash commutation.
Methodology: SERPS Adjustment	A firm will need to consider if and how the State Earnings Related Pension Scheme (SERPS) adjustment should be applied in the particular circumstances of the case to ensure that appropriate redress is offered to the complainant.	No SERPS adjustment is made in redress calculations for consumers who have transferred or opted-out post 6 April 2016. For transfers/opt-outs pre 6 April 2016, detailed information on the individual's State Pension calculation is to be obtained from DWP to accurately calculate the impact on the State Pension of the transfer/opt-out.

Proposed changes

The table below summarises the proposed approach to each of the areas considered in this Report.

Area of consideration	Proposed approach
Methodology: Actual Loss cases	**Discounted Mean Term (DMT):** For Actual Loss cases, the DMT to adopt to derive the assumptions to value the Future Loss should be based on the consumer's age at the Date of Calculation. Where a consumer is in-between the ages of the DMT's provided, the DMT should be based on linear interpolation and rounded to the nearest integer. **Marital/Civil Partnership Status:** The actual marital/civil partnership status at Date of Calculation should be used, if known. **Past Payments (Past Loss):** Past payments (both relating to the DB scheme and the DC scheme) should be increased from date of payment to Date of Calculation in line with Bank of England Base Rate over the period. **Default Early and Late Retirement Factors:** Early and Late retirement factors at the date of 'retirement' are a key data item for Actual Loss cases and every attempt should be made to obtain them. Where it is not possible to obtain the relevant information a default Early retirement factor of 4% p.a. compound and a default Late retirement factor of 5% p.a. compound should be adopted. These factors should be applied to the pension revalued to early/ late retirement date. **Approach to allow for PCLS:** For cases where the consumer is deemed to have 'retired' and thus the DB scheme benefits are being valued on an Actual Loss basis, PCLS should be allowed for based on actual original DB scheme PCLS factors at the assumed date of retirement. It should be assumed that the consumer would commute the HMRC maximum other than in the following scenarios: • where a consumer purchased an annuity in the DC scheme and took a lower PCLS amount, the allowance for PCLS in the calculation should be modified to reflect the actual pension commencement lump sum amount taken. • where the pension commencement lump sum was an additional benefit to the pension income in the DB scheme. In this scenario, no allowance should be made for cash commutation. • where the consumer had an AVC fund or DC section within the DB scheme, where the DB scheme allowed the PCLS to be taken from those sources before commuting DB pension. In these circumstances, the amount of PCLS should be modified to reflect the amount the consumer would have taken from the DB scheme (assuming they would have taken the HMRC maximum in totality). PCLS factors at the date of 'retirement' are key data items for Actual Loss cases and every attempt should be made to obtain them. Where it is not possible to obtain the relevant information, a default PCLS factor of 20 should be adopted.

Conclusion

Disclosure to consumers

Throughout the sections of this Report we have set out additional information which we consider should be disclosed to consumers as part of the redress offer process, in addition to the standard disclosures.

This disclosure of information is designed to provide the consumer with sufficient information to understand the assumptions underpinning the redress offer. This will support the FCA objective of ensuring key elements of the redress calculation are transparent and explainable to consumers.

Overall approach

- It should be made clear to consumers that the redress offer is based on providing an amount of money, that if invested in line with the pre-retirement discount should enable the consumer at assumed retirement age to purchase an annuity to replicate the benefits in the DB scheme.
- For Actual Loss cases, it should be made clear to consumers that whilst they cannot be mandated to purchase an annuity, if they choose not to they are exposing themselves to investment, inflation and longevity risks.

Pre-retirement Discount Rate

- There will be a wide range of investments which consumers are actually invested in and these will in some cases differ to that being assumed for the pre-retirement discount rate assumption used in redress calculations.
- It should be made clear to the consumer what investment strategy (and thus discount rate assumption) is being assumed in setting the pre-retirement discount rate. It should explain that if the consumer is invested differently post redress settlement the ultimate impact on their benefits may vary.

Charges

- The actual charges currently being incurred by the consumer should be disclosed or it should be acknowledged that these are unknown. The corresponding amount of the charges allowed for in the redress calculation along with the rationale for any cap applied should be stated.
- It should be clearly communicated what has been assumed in respect of the future charges (both pre and post retirement) relative to the consumer's circumstances (in particular for Actual Loss cases where a consumer is in drawdown) and the impact this could have.

Actual Loss cases

- The FCA is considering adopting an 'indicators of retirement' approach to determine whether a consumer has 'retired' and thus whether a redress calculation should be undertaken on Actual Loss basis.
- Where this is the case, the redress offer should set out the assumed retirement age adopted in the redress calculation and the factors that have been considered by the Redress Provider in making the decision on the consumer's assumed retirement age (and thus whether the case has been calculated on a Prospective Loss or Actual Loss basis).
- Where DB scheme specific PCLS, Early Retirement or Late Retirement factors are not available and instead 'default' factors have been adopted, this should be disclosed to the consumer.

To deliver consistency across the market, the FCA may wish to consider providing Redress Providers with a template 'redress offer letter' setting out the specific disclosure items required to be provided to the consumer.

9. Example Consumers

Example Consumers

Examining the impact of our proposals – basic details

Within our calculation analysis we have included examples of redress calculations for a small number of indicative consumers to show the impact of our proposed changes. The consumers we have used are set out in the table below with further details on the next page.

Consumer ID	Consumer 1	Consumer 2	Consumer 3	Consumer 4	Consumer 5	Consumer 6	Consumer 7	Consumer 8
Date of Birth	17/02/1968	18/05/1957	27/04/1982	13/10/1955	21/12/1967	05/11/1945	02/04/1967	01/05/1959
Date of Leaving	01/01/2020	01/05/1992	03/01/2015	01/01/2016	05/01/2017	06/01/1993	07/01/2019	08/01/2010
Sex	Male	Male	Male	Male	Female	Female	Female	Female
Retirement Age	65	58	60	65	60	60	65	60
Term to Retirement	10	-	20	-	5	-	10	-
Normal Retirement Age	65	65	60	60	60	60	65	65
Actual/Prospective Loss	Prospective	Actual	Prospective	Actual	Prospective	Actual	Prospective	Actual
Marital Status	Married	Single	Single	Married	Single	Married	Married	Single
Type of Retirement		Early		Late		Normal		Early
Spouse's Proportion	50%	50%	67%	67%	50%	50%	67%	67%
Charges	1%	-	1%	-	0.50%	-	0.50%	-
Pension Amount								
Pre 88 GMP	£ -	£ 50.00	£ -	£ -	£ -	£ 50.00	£ -	£ -
Post 88 GMP	£ 100.00	£ 100.00	£ -	£ -	£ 100.00	£ 100.00	£ 100.00	£ -
Pre 97 XS	£ 3,500.00	£ 4,800.00	£ -	£ -	£ 2,600.00	£ 12,400.00	£ 3,900.00	£ -
Post 97 XS	£ 5,911.30	£ -	£ 1,913.97	£ 4,291.99	£ 5,955.27	£ -	£ 5,902.69	£ 3,834.78
Post 09 XS	£ 5,288.70	£ -	£ 2,786.03	£ 3,408.01	£ 3,844.73	£ -	£ 4,797.31	£ 365.22

Example Consumers

Examining the impact of our proposals – further details

Within our calculation analysis we have included examples of redress calculations for a small number of indicative consumers to show the impact of our proposed changes.

Consumer ID	Consumer 1	Consumer 2	Consumer 3	Consumer 4	Consumer 5	Consumer 6	Consumer 7	Consumer 8
Increases in Deferment								
GMP	Fixed	S148	S148	Fixed	S148	Fixed	Fixed	S148
Pre 97 XS	CPI Max 5%	RPI5	RPI5	Statutory (CPI)	RPI5	Statutory (CPI)	Statutory (CPI)	RPI5
Post 97 XS	CPI Max 5%	RPI5	RPI5	Statutory (CPI)	RPI5	Statutory (CPI)	Statutory (CPI)	RPI5
Post 09 XS	CPI Max 5%	RPI5	RPI5	Statutory (CPI)	RPI5	Statutory (CPI)	Statutory (CPI)	RPI5
Increases in Payment								
Pre 88 GMP	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Post 88 GMP	Statutory (CPI3)	Statutory (CPI3)	Statutory (CPI3)	Statutory (CPI3)	Statutory (CPI3)	Statutory (CPI3)	Statutory (CPI3)	Statutory (CPI3)
Pre 97 XS	CPI (0,5)	RPI (0,5)	RPI (0,5)	CPI (0,5)	RPI (0,5)	CPI (0,5)	CPI (0,5)	RPI (0,5)
Post 97 XS	CPI (0,5)	RPI (0,5)	RPI (0,5)	CPI (0,5)	RPI (0,5)	CPI (0,5)	CPI (0,5)	RPI (0,5)
Post 09 XS	CPI (0,2.5)	RPI (0,2.5)	RPI (0,2.5)	CPI (0,2.5)	RPI (0,2.5)	CPI (0,2.5)	CPI (0,2.5)	RPI (0,2.5)
DC approach	n/a	Annuity	n/a	Drawdown	n/a	PCLS	n/a	Annuity
Taken PCLS?	n/a	Yes	n/a	No	n/a	Yes	n/a	Yes
Scheme PCLS factor								
Pre 97 XS	n/a	15	n/a	n/a	n/a	15	n/a	22
Post 97 XS	n/a	15	n/a	n/a	n/a	15	n/a	22
Post 09 XS	n/a	15	n/a	n/a	n/a	15	n/a	18

Example Consumers

Examining the impact of our proposals – results

The table below shows the impact of our proposed changes to the redress methodology on eight example consumers. All calculations are undertaken as at 1 April 2022, the same calculations undertaken at a different date may have produced different results. It should be noted that the percentage impact on redress would differ depending on the value of the DC benefits.

We have assumed that the consumers identified as Actual Loss cases are treated as Actual Loss under both the current FG 17/9 Guidance and under our proposed changes. Whether this is the case would depend on the approach taken for Actual Loss cases as discussed in Section 6 (Actual Loss) of this Report. We have not included any allowance for a SERPS adjustment in the figures below.

	Consumer 1	Consumer 2	Consumer 3	Consumer 4	Consumer 5	Consumer 6	Consumer 7	Consumer 8
Key data								
Date of Birth	17/02/1968	18/05/1957	27/04/1982	13/10/1955	21/12/1967	05/11/1945	02/04/1967	01/05/1959
Retirement Age	65	58	60	65	60	60	65	60
Term to Retirement	10	-	20	-	5	-	10	-
Actual/Prospective Loss	Prospective	Actual	Prospective	Actual	Prospective	Actual	Prospective	Actual
Marital Status	Married	Single	Single	Married	Single	Married	Married	Single
Charges (p.a.)	1%	-	1%	-	0.50%	-	0.50%	-
Results								
Value of Defined Benefits at Date of Calculation - Current Approach	£498,312	£370,729	£280,159	£379,654	£598,256	£675,936	£496,024	£210,314
Value of Defined Benefits at Date of Calculation – Proposed Approach	£512,215	£361,045	£260,737	£372,238	£542,725	£669,764	£501,330	£204,830
Change in Value increase/(decrease)	£13,903	(£9,684)	(£19,422)	(£7,416)	(£55,531)	(£6,172)	£5,306	(£5,484)
% Change in Value increase/(decrease)	2.8%	(2.6%)	(6.9%)*	(2.0%)	(9.3%)*	(0.9%)	1.1%	(2.6%)

*This reduction for consumers 3 and 5 is primarily caused by the fact the consumers are single and therefore under the proposed assumptions the proportion married/in civil partnership assumptions would be 40% and 11% respectively, compared to the 85% assumed in the current FG 17/9 Guidance.

Glossary

Glossary

Definition of Key Terms

Key Term	Definition
CMI	The Continuous Mortality Investigation of the Institute and Faculty of Actuaries
DWP	Department for Work and Pensions
FCA	Financial Conduct Authority
FOS	Financial Ombudsmen Service
FRC	Financial Reporting Council
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
HMRC	Her Majesty's Revenue & Customs
OBR	Office for Budget Responsibility
ONS	Office for National Statistics
PIA	Personal Investment Authority
PPF	Pension Protection Fund
SIB	Securities & Investment Board
UKSA	UK Statistics Authority

Glossary

Definition of Key Terms

Key Term	Definition
Date of Calculation	The effective date at which the redress calculation is performed
Date of Leaving	Date at which the consumer became a deferred member in their DB Scheme
DB	Defined Benefit
DC	Defined Contribution
Settlement Date	The date at which the consumer's complaint is settled and redress paid to the consumer
Actual Loss	When an event (such as death or retirement) has already occurred giving rise to benefits and the benefits from the personal pension are less than those the occupational scheme would have conferred.
FSAVC	Free standing additional voluntary contributions
Future Loss	Relating to the theoretical loss in benefits post Date of Calculation
Non-joiner	An individual who has declined or failed to join an occupational scheme for which he or she was eligible, while continuing in the relevant employment
Opt-out	The giving up of active membership of an occupational scheme while continuing in the relevant employment. This includes the situation where an individual remained in an occupational scheme for life assurance purposes only, but left the scheme for pension purposes
Past Loss	Relating to the actual loss in benefits received between date of 'retirement' and Date of Calculation
Prospective Loss	Where the consumer (or their spouse or dependants) are exposed to the probability of an actual financial loss when an event such as death or retirement occurs in the future
Transfer	The payment into a DC arrangement of the cash value of accrued benefits under an occupational scheme for a member who has left active membership of that scheme.
TVC	Transfer Value Comparator

Glossary

Definition of Key Terms

Key Term	Definition
AVC fund	A fund built up of additional voluntary contributions, which contributes to an additional retirement fund for the consumer
Barber tranche	The tranche of pension benefits accrued between the Barber date (17/05/1990) and the date the DB scheme equalised retirement ages for male and female members, known as its equalisation date.
Black Scholes model	A deterministic statistical model used in pricing financial instruments
Deferred annuity	An annuity commencing after the lapse of some specified time, also following the payment of the final purchase premium
Discounted mean term (DMT)	The weighted average term of future cashflows
Enhanced transfer Value	A higher than statutory transfer value, offered as an incentive to leave the pension scheme at that time
Escrow account	An third-party account where funds are held until specified conditions are met before being transferred to the ultimate party
Impaired lives	A person whose physical condition (according to specified tests) is below a certain level entitling them to insurance products at non-standard rates
Inflation Risk Premium (IRP)	An adjustment made to market implied inflation to account for non-inflation related factors contained within the stated inflation rate.
PCLS factors	The set rates that a DB scheme uses in order to exchange part of the consumer's pension for a PCLS
Pension Commencement Lump Sum (PCLS)	A tax-free payment which most consumers can receive once they start accessing their pension benefits
Section 148 orders (S148 orders)	Section 148 revaluation orders for GMP, published each April showing the percentage increases to be applied based on the increase in national average earnings for the year. As required by section 148 of the Social Security Administration Act 1992

Glossary

Definition of Key Terms

Key Term	Definition
DISP	FCA Handbook - Dispute Resolution: Complaints
Pension Review	A review carried out by the SIB amid concerns about the mis-selling of personal pension policies between 29 April 1988 and 30 June 1994
SIB guidance	The series of guidance issued by the SIB and published in the 1990's covering transfer, opt-out and non-joiner cases as part of the Pension Review
TM1: Statutory Money Purchase Illustrations ("SMPI")	Specifies the assumptions and methods to be used in the calculation of statutory illustrations of money purchase pensions. Published by the Financial Reporting Council
Annuity providers	Companies who provide an insurance product that allows consumers to swap their pension savings for a guaranteed regular income
GPP arrangements	Group Personal Pension arrangements, where members use group schemes to build up their own pension pot
Redress Provider	The individual or firm responsible for the provision of unsuitable advice and undertaking and/or settling redress calculations
UK DC Master Trusts	UK multi-employer defined contribution pension schemes
PPF Assessment Period	The period during which a pension scheme is assessed to determine whether the PPF should assume responsibility for it.
PPF benefits	The benefits which would be received by members of schemes entering the PPF. These may be different to those received in their original DB scheme.

Glossary

Definition of Key Terms

Key Term	Definition
CAPS 'Mixed with Property' Fund	A fund as referenced in “FSAVC Review Model Guidance” dated May 2000, as issued by the FSA. The use of this fund was discontinued on 1 January 2005, and the FTSE UK Private Investor Growth Total Return Index has been used post 1 January 2005.
Consensus Economics	An entity that publishes monthly compilations of economic forecasts and topical analyses covering the G-7, Asia Pacific, Eastern Europe and Latin America. These forecasts are based on the analyses of a network of over 700 economists in consultancies and banks. Macroeconomic indicators published include GDP growth, inflation, production, interest rates and exchange rates as well as more than 40 key energy and metal prices. Consensus Economics data is widely used for macroeconomic forecasting by both private sector and public sector institutions.
FTSE UK Private Investor Growth Total Return Index	A multi-asset index series providing market participants in the UK with a set of asset allocation benchmarks covering equities, fixed income, cash, property and other investments. Designed to represent the performance of a mixed asset benchmark with high historical levels of volatility
Sterling Overnight Index Average (SONIA)	An interest rate benchmark which reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors

Appendix 1

Appendix 1

DC funds analysed

Our analysis of the average default strategy for several of the major UK DC Master Trusts, along with major GPP arrangements, included the following:

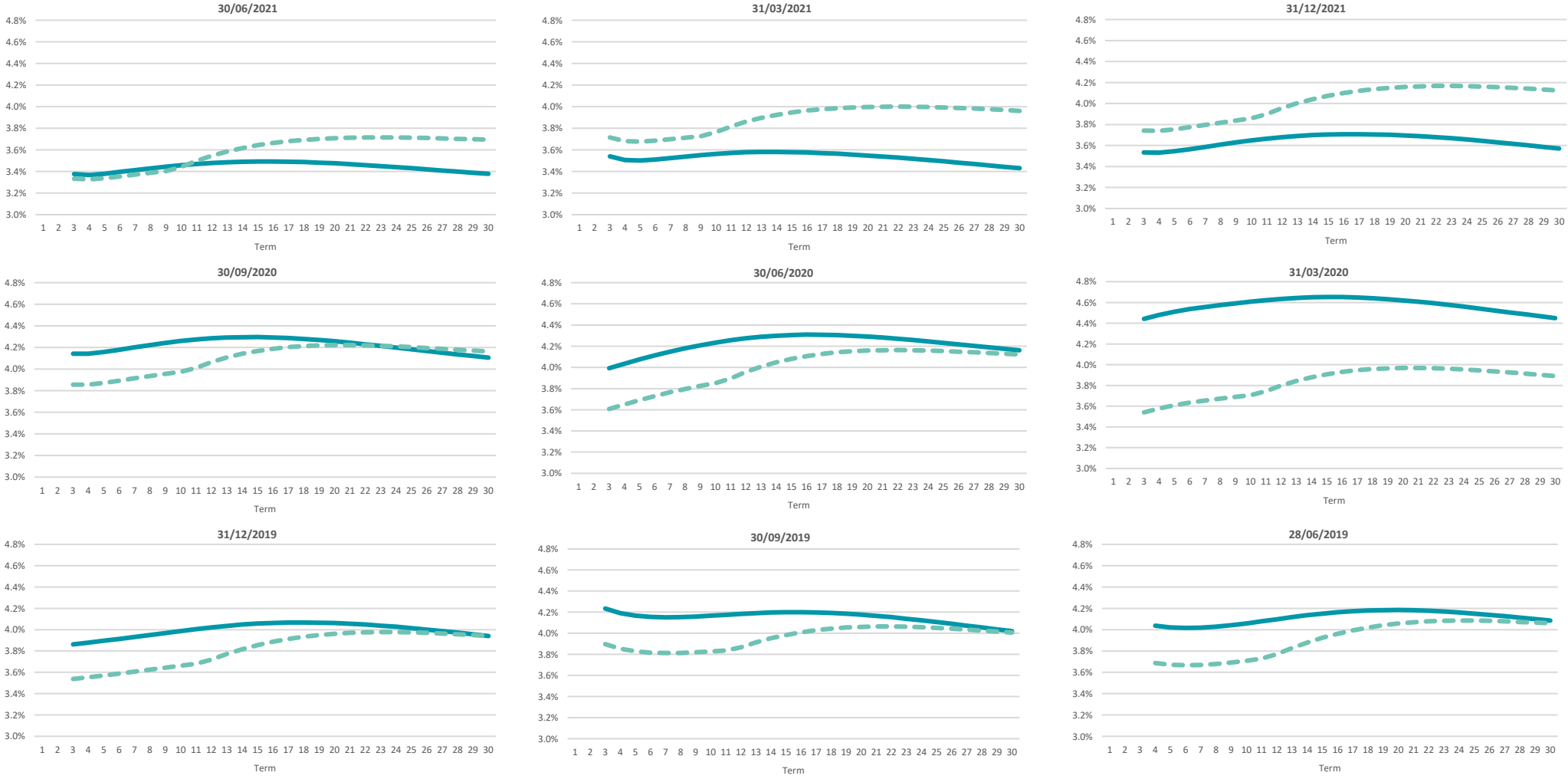
- Aegon
- Aon
- Aviva
- Fidelity
- L&G
- Mercer
- NEST
- People's Pension
- Scottish Widows
- Standard Life

Appendix 2

Appendix 2

Historic Pre-retirement discount rates

The graphs below show the pre-retirement discount rate based on the current FG 17/9 Guidance and the amended approach proposed in this Report. These are included to show the difference in impact at different dates and terms. The difference in the two approaches at a particular past date should not be interpreted as any comment on the appropriateness of the assumptions methodology at that time. The proposed approach is based on current market conditions and considered appropriate for future calculation dates. Elements such as future inflation expectations may have resulted in different conclusions at different historic dates.



Appendix 3

Appendix 3

Pension Increases in Payment – Black's Model

Under this model, it is assumed that the underlying rate being modelled is distributed log-normally with a volatility σ defined by the user.

The overall equation and components used within the calculation to derive the assumption are detailed below.

For pensions increases subject to a Minimum ("Floor") and Maximum ("Cap"), the pension increase assumption for a set Inflation Assumption is calculated as follows:

$$\textbf{\textit{Pension Increase Assumption}} = Floor + Call\ Price\ (Floor) - Call\ Price\ (Cap)$$

Where:

$\textbf{\textit{Stock Price}}\ (\boldsymbol{S}) = 1 + Inflation\ Assumption$

$\textbf{\textit{Strike Price}}\ (\boldsymbol{K}) = 1 + Floor \quad or \quad 1 + Cap$

$\textbf{\textit{Volatility}} = \sigma$ = 1.0% (example rate)

$$\boldsymbol{d_1} = \frac{ln\left(\frac{S}{K}\right) + \left(\frac{\sigma^2}{2}\right)}{\sigma}$$

$\boldsymbol{d_2} = d_1 - \sigma$

$\boldsymbol{N} = Cumulative\ Standard\ Normal\ Distribution\ Table$

$\textbf{\textit{Call Price}}\ (\boldsymbol{C}) = SN(d_1) - KN(d_2)$

These values are taken from the Cumulative Standard Normal Distribution Table

Appendix 3

Pension Increases in Payment – Black's Model – Example

Set out below is an example for calculating the pension increase assumptions using the Black Scholes approach.

Inflation Assumption	3.00%
Minimum = Floor	0.00%
Maximum = Cap	5.00%
Volatility (σ)	1.00%

	Floor	Cap
Stock Price (S): 1 + Inflation	(1 + 0.03) = 1.03	(1 + 0.03) = 1.03
Strike Price (K)	(1 + 0.00) = 1.00	(1 + 0.05) = 1.05
d_1	$\frac{\ln\left(\frac{1.03}{1.00}\right)+\left(\frac{(0.01)^2}{2}\right)}{0.01}$ = 2.96088	$\frac{\ln\left(\frac{1.03}{1.05}\right)+\left(\frac{(0.01)^2}{2}\right)}{0.01}$ = -1.91814
d_2	2.96088 – 0.01 = 2.95088	-1.91814 – 0.01 = -1.92814
Call Price	(1.03 x N(2.96088)) – (1.00 x N(2.95088)) (1.03 x 0.99847) – (1.00 x 0.99842) = 0.0300045	(1.03 x N(-1.91814)) – (1.05 x N(-1.92814)) (1.03 x 0.02755) – (1.05 x 0.02692) = 0.0001082

$Stock\ Price\ (S) = 1 + Inflation\ Assumption$

$Strike\ Price\ (K) = 1 + Floor\ or\ 1 + Cap$

$$d_1 = \frac{ln\left(\frac{S}{K}\right)+\left(\frac{\sigma^2}{2}\right)}{\sigma}$$

$d_2 = d_1 - \sigma$

$N = Normal\ Distribution\ Table$

$Call\ Price\ (C) = SN(d_1) - KN(d_2)$

$$\textbf{Pension Increase Assumption} = Floor + Call\ Price\ (Floor) - Call\ Price\ (Cap)$$

$$\textbf{Pension Increase Assumption} = 0.00 + 0.0300045 - (0.0001082) = 0.029896329 = \underline{2.99\%}$$

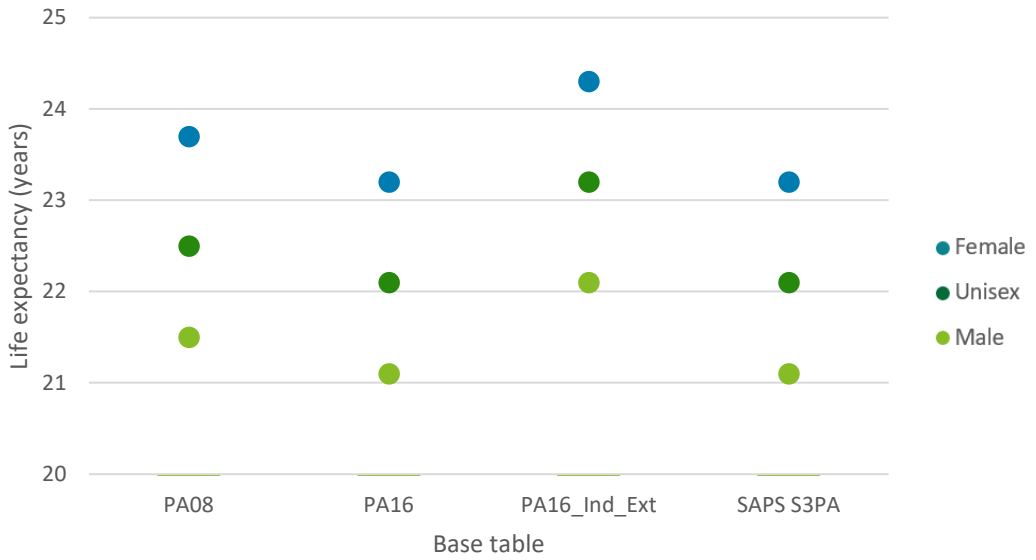
→ Rounded to 3.00%

Appendix 4

Appendix 4

Mortality assumptions

The below table compares the future life expectancy at age 65 for a 45 year old produced by each base table under consideration as at 1 April 2022. Allowance has been made for future improvements in longevity (in line with CMI20 unisex projections with a 1.25% p.a. long term trend and default parameters).



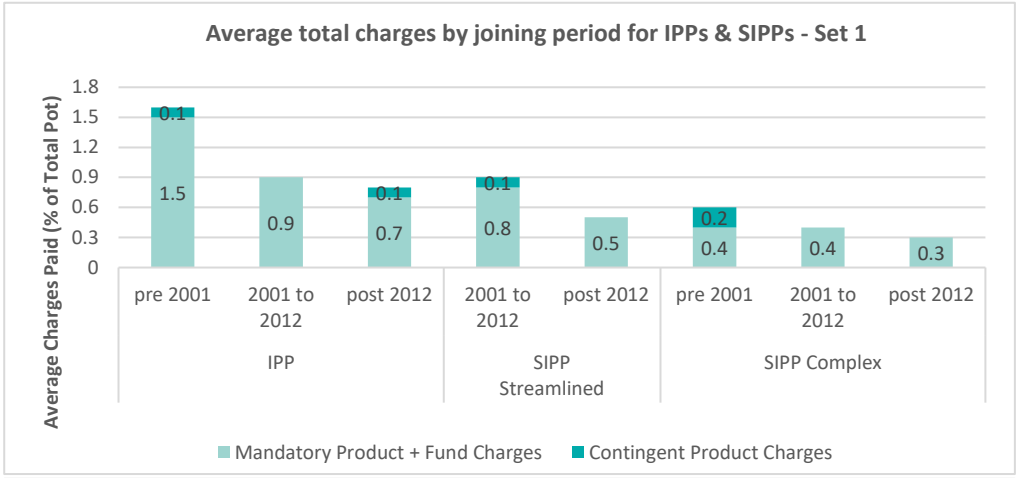
In line with the analysis for a current 65 year old as shown in Section 5d (Assumptions: Demographic) of this Report, the PA16 tables produce life expectancies which are slightly lower than the PA08 tables and broadly in line with the SAPS S3PA tables. The PA16_Ind_Ext tables produce life expectancies considerably higher than the other tables.

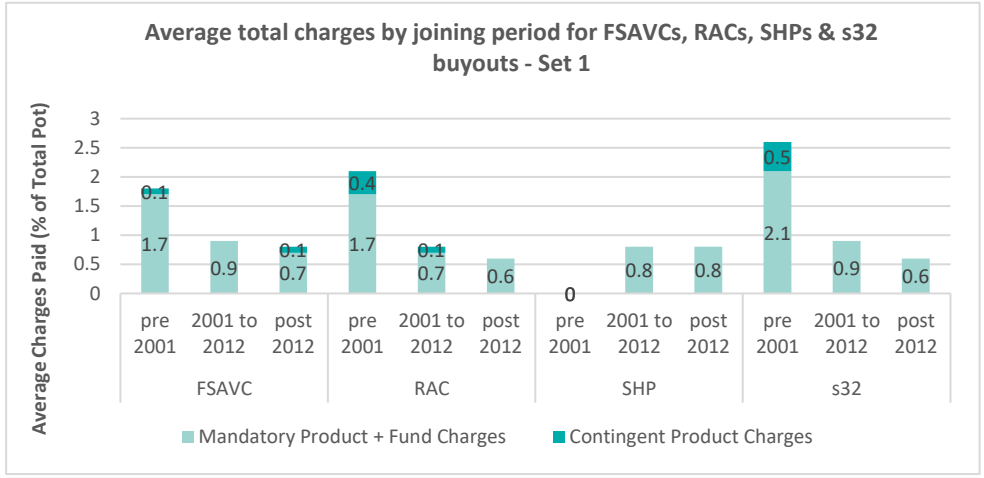
Appendix 5

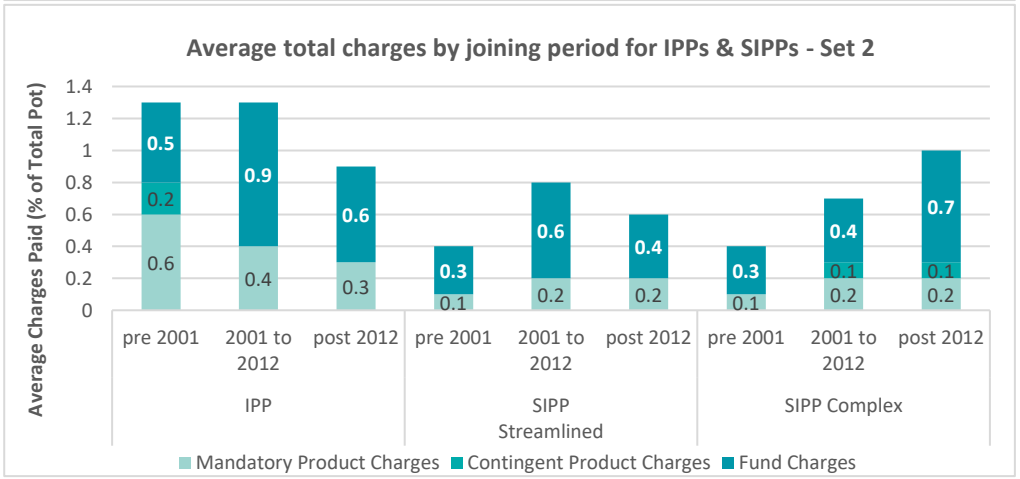
Appendix 5

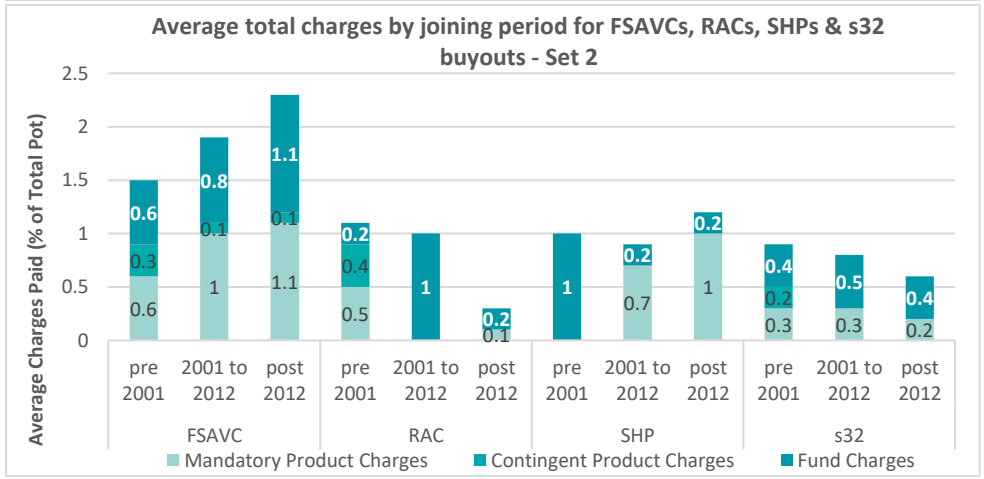
Analysis of Charges

The charts below are taken from FCA Feedback Statement FS 19/5[1]. Annex 3 provides analysis of the charges observed in the UK market for non-workplace pensions. This analysis evidences that charges are typically higher (in percentage terms) the longer ago the transfer was and the smaller the size of the consumer's DC fund. Details on the definitions (including Set 1 and Set 2) used can be found in the Feedback Statement. As can be seen from the charts below, the average charges incurred by consumers is 1.5% or below for consumers in IPPs and SIPPS. Charges are also on average below 1.5% for the majority of categories of consumers in FSAVCs, RACs, SHPs and s32 policies.









[1]www.fca.org.uk/publications/feedback-statements/fs19-5-effective-competition-non-workplace-pensions

Deloitte.

Please see “Scope of our Review” on page 7 for important information about this document.