

Appendix 4

Handling pension transfer redress calculations

4.5 Technical guidance

Annuity values

- App4.5.1** **G** When calculating the relevant annuity factor to value future payments from either the *defined benefit occupational pension scheme* or a guaranteed income previously secured from the proceeds of the DC pension arrangement, *firms* should allow for:
- (1) the form of the payments they are valuing, such as the proportion of spouse's benefits on death, frequency and timing of payments, annual increases, remaining guaranteed payment and whether survivor payments are with or without overlap relative to the guaranteed period;
 - (2) the proportion married:
 - (a) where the presumed retirement date is after the valuation date, using the assumptions in ■ DISP App 4 Annex 1 10.3G;
 - (b) where the presumed retirement date is prior to the valuation date:
 - (i) using the actual marital/civil partnership status; or
 - (ii) where the actual marital/civil partnership status is not known, using the assumption that the *consumer* is unmarried or not in a civil partnership; and
 - (3) the possibility that there may be other dependants who could have received benefits under the rules of the *defined benefit occupational pension scheme* or under the contract of any previously secured guaranteed income, and the same principles should be applied to such dependants.

Scheme benefits and rules

- App4.5.2** **G** When calculating the value of benefits in the *defined benefit occupational pension scheme*, *firms* should take account of the differences in pension tranches. This includes tranches such as bridging pensions which are payable only for a fixed

period. The valuation of benefits should take account of how the *consumer's defined benefit occupational pension scheme* provided for the interaction of any guaranteed minimum pension (GMP) tranches with the rest of the scheme benefits (the excess) when pensions are revalued in deferment and increased in payment, including the impact of anti-franking legislation.

Discount factor

- App4.5.3** G When the presumed retirement date is after the valuation date, ■ DISP App 4.4.6R(9) requires firms to use a discount factor ('R') to discount the annuity value at the future retirement date to the present day. The discount factor should be calculated as:

/MILES/PKF/fca/
graphics/Graphics
/DISP_APP_4_5_
3_20230401.png

where:

- (1) *r* is the pre-retirement discount rate net of charges, as set out in ■ DISP App 4.5.15G; and
- (2) *n* is the term to retirement.

Pension commencement lump sums

- App4.5.4** G
- (1) Where the retirement date is at or prior to the valuation date, a *firm* should assume that the *consumer* would have commuted the maximum *pension commencement lump sum* permitted by legislation, using the actual lump sum commutation factors at the retirement date, unless:
 - (a) the *consumer* has used the full value of their DC pension arrangement to secure a guaranteed annuity income, in which case *firms* should use the actual *pension commencement lump sum* taken by the *consumer* where this is lower than the maximum permitted by legislation from the *defined benefit occupational pension scheme*; or
 - (b) a *pension commencement lump sum* was payable in addition to the pension benefit in which case an adjustment should be made to assume the *consumer* took the maximum lump sum permitted overall (including the additional lump sum); or
 - (c) the *pension commencement lump sum* could have been funded by an additional voluntary contribution fund or a defined contribution section within the *defined benefit occupational scheme*, in which case *firms* should assume that those sources would have been used first to take the maximum permitted under legislation.
 - (2) A *firm* should base the order of commutation on the *defined benefit occupational pension scheme* rules but, where this is not known, the commutation should be proportionate across all pension tranches, excluding any guaranteed minimum pension.
 - (3) A *firm* must make reasonable efforts to obtain the actual lump sum commutation factors at the retirement date from the ceding scheme.

- (4) For the purposes of (3), where a *firm* has information on the commutation factors available either side of the retirement date, or other relevant information, it should use that information to derive the expected factors at the retirement date.
- (5) Where the information in (4) is not available or is insufficient to determine the appropriate factors, a *firm* should use the default rate in ■ DISP App 4 Annex 1 11.3G.
- (6) Where a different tax regime (to that currently in force) would have applied at the point of a *consumer's* retirement, this should be taken into account when calculating the maximum permitted by legislation.

Valuing the DC pension arrangement

App4.5.5 G Step 1 at ■ DISP App 4.3.3R(1) requires a *firm* to collect the necessary information about the *consumer's* DC pension arrangement. This information should include the value of the investments and holdings within the *consumer's* DC pension arrangement at the valuation date.

- App4.5.6** G
- (1) If an up-to-date valuation is not readily available for an investment (for example, if the investment is held in illiquid or unquoted assets or because the manager or provider of the DC pension arrangement is unable to provide a valuation), a *firm* should take the following action to place a value on those investments:
 - (a) where the investment is illiquid or unquoted but there is a realistic probability of receiving value from an asset, obtain the most recent historical valuation and, unless there is clear evidence that the value has otherwise materially changed, increase it in line with the consumer price index from the date of the historical valuation to the valuation date;
 - (b) where the investment is liquid, such as a fund, calculate the notional value of the fund by on the valuation date using available information. For example, using the known number of units and an available unit price, or a last known value and the change in the unit price (and allowing for known charges);
 - (c) where the investment is illiquid or unquoted and appears to have no realisable value, and there is no recent historical valuation, the *firm* should disregard the value of the investment.
 - (2) When deciding what action to take to place a value on investments, a *firm* should consider the reason why a valuation is not readily available for the investment and, in particular, seek to identify whether assets could be:
 - (a) associated with a scam;
 - (b) associated with illegal activity; or
 - (c) subject to insolvency procedures.
 - (3) Where the only available valuation of an investment is the book value, a *firm* should consider whether the book value is representative of what could realistically be realised from the investment and, if appropriate, adjust the valuation accordingly, which may include disregarding 100% of the book value of the investment.

- (4) Where a *consumer* received a cash enhancement (which was paid in addition to and not as part of the cash equivalent transfer value), a *firm* should calculate the current value of the cash enhancement by increasing it in line with returns indicated in the relevant assumptions in
- DISP App 4 Annex 1, from the date of payment to the valuation date.

Early and late retirement

- App4.5.7** **G** When a *consumer* is presumed to have retired at a date which they would not have been able to retire in the *defined benefit occupational pension scheme*, then the retirement date used to value the *defined benefit occupational pension scheme* benefits should be the earliest date at which the *consumer* could have retired from the *defined benefit occupational pension scheme*.

- App4.5.8** **G** Early and late retirement factors at the retirement date are key items of data and every attempt should therefore be made to obtain them. Where it is not possible to obtain the relevant information, a *firm* should use the default rates in
- DISP App 4 Annex 1. These factors should be applied to the pension revalued to early/late retirement date.

Other policies in conjunction with the transfer

- App4.5.9** **G** Any additional policies taken out in conjunction with the transfer (eg, life cover with a S.32) to replace life cover provided by the scheme should be taken into account. Consequently, where a claim arises under these policies, the amount paid offsets the loss. Where the investor has paid for this cover, the loss should be increased by the accumulated value of the premiums paid accumulated at bank base rates. This adjustment should be strictly limited both in terms of claims and premiums to that proportion of the benefits under the additional policies that replaced those under the scheme.

Contracted-out schemes

- App4.5.10** **G** Where retirement took place following a transfer from a contracted-out scheme, the precise formula depends on whether the contracted-out pension rights were also transferred. If they were not transferred, then they should not be taken into account when assessing loss.

Adjustment for SERPS

- App4.5.11** **G**
- (1) A SERPS adjustment is not needed when the *consumer* transferred out or opted out of their contracted-out *defined benefit occupational pension scheme* from 6 April 2016.
 - (2) Where contracted-out pension rights from the *defined benefit occupational pension scheme* were transferred into the DC pension arrangement/section 32 buyout plan before 6 April 2016, a *consumer's* state pension entitlement may differ from that which would have been payable had the transfer not taken place.
 - (3) Allowance should be made for this difference by making a SERPS adjustment which values the difference in the *consumer's* state pension entitlement before and after the transfer. A *firm* will need to obtain the detailed information on the *consumer's* state pension entitlement to assess the impact on their starting amount of state pension.

Pension increases in deferment (revaluation)

- App4.5.12 **G**
- (1) When the *defined benefit occupational pension scheme* provides fixed rates of revaluation, a *firm* should use fixed rates for future revaluation.
 - (2) When the *defined benefit occupational pension scheme* provides revaluation increases based on *RPI, CPI and earnings inflation*, a *firm* should try to obtain information on how the scheme applies increases. This would include the month in which each index is both sourced and applied.
 - (3) A *firm* should apply increases for guaranteed minimum pensions for complete tax years.
 - (4) Unless the *defined benefit occupational pension scheme* provides otherwise, a *firm* should treat benefits linked to inflation as increasing by inflation over the whole period of revaluation rather than on a year-by-year basis. A *firm* should not make an adjustment for an individual year of negative inflation.
 - (5) When the *defined benefit occupational pension scheme* provides for pre-retirement pension increases to be capped on an annual basis, the Black-Scholes model should be applied for future revaluation assumptions, consistent with the approach for pension increases in payment in **■ DISP App 4 Annex 1 6.1G**.

Pension increases in payment

- App4.5.13 **G**
- Where a *firm* values income benefits with increases in payment which are:
- (1) fixed, they should use those fixed rates; or
 - (2) dependant on *RPI* or *CPI*, they should use the relevant assumptions in **■ DISP App 4 Annex 1**.

Multiple product providers

- App4.5.14 **G**
- Where the transfer value was split between 2 product providers, the loss may be assessed in 2 parts, with the occupational scheme benefits split in proportion to the transfer value.

Ongoing charges

- App4.5.15 **G**
- (1) Where the *consumer's* retirement date is after the valuation date, **■ DISP App 4.4.6R(9)** requires a *firm* to net down the pre-retirement discount rate for the default product and *adviser charges* using the relevant assumptions in **■ DISP App 4 Annex 1**. Ongoing *adviser charges* should be included in all circumstances.
 - (2) When netting down the pre-retirement discount rate, a *firm* should use the following formula:

$$[(1 + i\%) \times (1 - c\%)] - 1$$
 where:
 - (a) *i%* is the pre-retirement discount rate (unadjusted for charges) each year; and
 - (b) *c%* is the sum of the default product and *adviser charges* each year.

Free standing additional voluntary contributions performance comparator

- App4.5.16** **G** Where *firms* need to make an assumption on returns within an in-house additional voluntary contribution arrangement, they should use the relevant assumption in ■ DISP App 4 Annex 1.

Death of the consumer before the valuation date

- App4.5.17** **G** Where the *consumer* died before the valuation date, either before or after retiring, *firms* should apply the principles of the formulae in ■ DISP App 4.4.2 to ■ 4.4.19R.

Taxation when valuing past payments

- App4.5.18** **G**
- (1) When a *firm* is valuing past payments made before the valuation date where the *consumer* has died or would have retired if they had remained in their *defined benefit occupational pension scheme*, it should value the payments from the:
 - (a) DC pension arrangement net of any actual tax incurred; and
 - (b) notional payments from the *defined benefit occupational pension scheme* using the tax rate that would have applied if these payments had been made.
 - (2) App 4.5.18G(1) does not apply when a *firms* is rolling up past payments made from the DC pension arrangement to add back into the value of the DC pension arrangement where the *consumer* would not yet have retired from their *defined benefit occupational pension scheme*.