

## Ombudsman's Determination

Applicant	Mr T
Scheme	Social Housing Pension Scheme ( <b>the Scheme</b> )
Respondents	TPT Retirement Solutions ( <b>TPT</b> )  The Trustees of the Social Housing Pension Scheme ( <b>the Trustee</b> )

## Outcome

1. I do not uphold Mr T's complaint and no further action is required by TPT or the Trustee.

## Complaint summary

2. Mr T believes the actuarial factor used in calculating his pension commencement lump sum (**PCLS**) and reduced pension is too low in comparison to the actuarial factor used to produce a transfer value from the Scheme. Mr T wants his PCLS increased in line with the factor used to produce a transfer value.

## Background information, including submissions from the parties

3. Mr T was an employee of Brunelcare and was an active member of the Scheme, which is a defined benefit arrangement. Mr T's normal Scheme retirement age was 65.
4. Having received a request for retirement illustrations, TPT wrote to Mr T on 20 December 2017 to set out his retirement options, providing related paperwork and information relevant to his retirement. His options were as follows:-
  - Estimated transfer value of defined benefits: £240,859.90
  - Option 1 Full pension of £8,537.43, a survivor's pension, no PCLS.
  - Option 2 PCLS of £39,633.83, pension of £5,945.12, a survivor's pension.
  - Option 3 Enhanced pension of £9,248.88, no survivor's pension.

- Option 4    Enhanced PCLS of £42,935.65, reduced enhanced pension of £6,440.54, no survivor's pension.
5. On 29 December 2017, Mr T emailed TPT to query the figures provided in the illustrations, saying that the transfer value equated to a pension of £9,248.88. However, Option 4 involved giving up pension income of £2,808.34 or 30% of the pension. Accordingly, he argued, the lump sum under Option 4 should be approximately 30% of the transfer value, being around £73,000 rather than the £42,936.65 quoted on the illustrations. He sought an explanation for this apparent inconsistency.
  6. On 6 January 2018, TPT responded to Mr T's email to explain the transfer value quoted in the illustrations was not a cash value payable to the Member. Rather it was the estimated value of the cost to an alternative pension provider to offer similar benefits to those available from the Scheme. The PCLS, on the other hand, was calculated by using a commutation factor based on Mr T's age and the date he elected to take his pension.
  7. On 15 January 2018, Mr T emailed TPT again saying his question had not been answered by TPT's response of 6 January 2018. Instead, it had reinforced his point, which was that the transfer value represented the value of the pension given up. Using the figures from the illustration, the transfer value represented approximately £26 for each £1 of pension given up. However, for commutation, a pension of £2,808.34 produced a PCLS of £42,939.35, or approximately £15.30 for each £1 of pension given up. It was this disparity which concerned Mr T. He asked for an actuary to check the figures and provide details of the mortality rates, interest rates and inflation assumptions used in reaching the figures illustrated to him.
  8. TPT responded to Mr T and confirmed that the figures quoted were correct. TPT also explained that the calculations used to produce an estimated transfer value and the commutation factor used to establish the PCLS were two different calculations, produced using totally different methods from each other.
  9. On 23 February 2018, Mr T spoke with TPT by telephone. He indicated his dissatisfaction with its response to his concerns. He said he did not understand how giving up pension for a PCLS at a ratio of 15:1 could be correct when the ratio for a transfer value was 26:1. He wanted to know exactly how the calculations were achieved and asked for an actuary to call him back for an in-depth discussion on the matter.
  10. On 5 March 2018, TPT telephoned Mr T again, saying that it was commonplace for transfer values to be calculated at around 25 to 30 times the Scheme pension. TPT also confirmed commutation factors were set by the Actuary. Mr T disagreed, saying the calculation was the same, and the difference between the ratio for commutation for the PCLS and the ratio for a transfer value was too great. He asked again to speak with an actuary.

11. Following a telephone conversation with an in-house actuary on 23 March 2018, TPT wrote to Mr T on 28 March 2018 and said:-

- It understood that Mr T was querying the difference between the lump sum available by commuting a portion of the pension in return for a PCLS and the transfer value.
- The actuary had confirmed the main reason for this difference was the different legal requirements applicable to commutation and to transfer values.
- Since 2008, legislation required that transfer values be calculated to reflect prevailing market conditions, producing an estimate of the Trustee's best estimated cost of providing equivalent benefits to those obtainable if taken from the Scheme.
- However, the requirements for commutation factors arose from the Scheme Rules, not from legislation. The Scheme Rules stated that "the Trustee will convert pension to lump sum on a basis it decides after considering "Actuarial Advice".
- The amount available for a PCLS can then be reduced by the Trustee to reflect any Scheme deficit, although the Scheme was not currently in deficit.
- The Scheme Rules impose no obligation on the Trustee other than the requirement to take actuarial advice. In particular, the Trustee is not required to warrant that the commutation factors adequately reflect the value of the pension given up. Further, there is no requirement for the factors to reflect current market conditions.
- Mr T's request for details of the actuarial basis underlying the commutation factors could not be fulfilled because these were simply fixed factors, not derived using a particular calculation method.
- The Trustee generally reviews commutation factors annually. The substantial difference between commutation factors and transfer values would also be considered during the ongoing review of Scheme funding. However, no guarantee of any particular outcome of the review could be offered.

12. On 26 July 2018, Mr T sent TPT a copy of the Institute of Actuaries' 'Risk Alert' document, saying point 4 of this document was relevant to the issue he had raised. He sought confirmation as to whether, or not, the Scheme Actuary believed that his advice to the Trustee complied with the professional guidance provided by the 'Risk Alert'.<sup>1</sup>

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<sup>1</sup> The 'Risk Alert' is a document from the Institute and Faculty of Actuaries, which offers non-mandatory guidance on subjects of relevance to areas of finance where actuarial input is appropriate. The 'Risk Alert' in this case relates to pension commutation factors, which should be kept current in respect of increasing longevity and falling bond yields.

13. On 14 August 2018, TPT wrote to Mr T and confirmed the Scheme Actuary had included a copy of the 'Risk Alert' in their latest advice to the Trustee. It also confirmed the Scheme Actuary had taken into account all other professional requirements. It said the factors were under regular review, had been reviewed in April and June 2018, and would be reviewed again later in the year.
14. On 21 August 2018, Mr T raised a formal complaint saying he believed the Trustee was treating certain Scheme members unfairly as it used different factors for transfer values than those used to commute pension for a PCLS.
15. On 6 November 2018, TPT issued its Stage 1 response under its Internal Dispute Resolution Procedure (**IDRP**). It did not uphold Mr T's complaint and made the following points:-
  - In making any decision, the Trustee must:-
    - Comply with the Scheme Rules;
    - Consider all relevant factors and disregard irrelevant factors; and
    - Reach a decision that a reasonable body of trustees could reach and which a court or Ombudsman would not consider perverse.
  - The Trustee instructs the Scheme Actuary to review commutation factors annually.
  - Having considered the Scheme Actuary's advice, the Trustee decides whether, or not, to amend the retirement and commutation factors.
  - In 2016 the Trustee increased the commutation factors by 15% but no change was made in 2017. However, conditions in 2018 enabled the Trustee to make a further improvement to commutation factors.
  - While there are regulations relating to methodology in calculating transfer values, commutation factors are governed by the Scheme Rules, which in this case state that:-

“The Trustee will convert pension to lump sum on a basis it decides after considering Actuarial Advice.”
  - The Scheme Rules do not create any obligation regarding commutation figures other than for the Trustee to take actuarial advice, which it does on an annual basis.
  - In particular, the Trustee is “not required to warrant that the commutation factors adequately reflect the value of the pension foregone”.
  - Commutation rates set across UK pension schemes vary significantly and few schemes offer rates anywhere close to the best estimate factors used when calculating transfer values, due to the cost impact.

- There are significant differences between transfer values and tax-free cash lump sums. In particular, typically only 25% of the sum transferred can be taken tax-free while commutation factors make allowance for the fact that a survivor's pension is retained.
  - Mr T's view that commutation factors represented poor value for money was noted, particularly when compared to the pension to transfer ratio, but this was not a "like for like" comparison.
  - As could be seen from recent improvements in commutation factors, this was an area which was kept under regular review.
16. Mr T sent another email to TPT on 14 November 2018 asking for the following:-
- What was the most recent actuarial advice given to the Trustee?
  - What allowance is made in respect of survivor's benefits where pension is commuted for PCLS?
  - Would TPT provide a copy of the Scheme Rules relating to the commutation factors?
17. On 22 November 2018, Mr T made a further request for a copy of the Scheme Rules relating to commutation factors.
18. On 23 November 2018, TPT responded to Mr T's emails of 14 and 22 November 2018 as follows:-
- In the most recent actuarial review, the Scheme Actuary had advised the Trustee that there was further scope to improve commutation factors. The Trustee had considered that advice and had decided to make a further improvement to commutation factors.
  - In respect of any allowance made regarding dependents benefits, a full survivor's pension continues to be payable to a survivor where the member had commuted pension for a PCLS. The commutation factor only affects the value of the member's pension, and does not affect any survivor's pension that may be due in future. However, paying out a transfer value extinguishes both the member's and any survivor's pension that may have become payable had the member died. The transfer value reflects the probability of a survivor's pension being due in any future year.
  - Scheme Rules 6.1 (Retirement lump sum), 13.1 (commutation) and 13.2 (Restrictions) were also set out as per Mr T's request (See Appendix).
19. On 19 December 2018, Mr T sent a further email to TPT asking:-

- TPT to establish whether, following the latest improvement in commutation factors, the Scheme Actuary was satisfied that the risk highlighted in the Institute of Actuaries' 'Risk Alert' of 30 June 2016 was no longer applicable.
- Alternatively, does the Scheme Actuary think there needs to be further improvement to ensure consistency between Cash Equivalent Transfer Values (**CETV**) and commutation factors for members who were close to retirement age?
- TPT to provide retirement quotations.

20. On 25 January 2019, TPT emailed Mr T and responded to his questions as follows:-

- The considerations set out in the 'Risk Alert' remained relevant to the Scheme Actuary whenever advising the Trustee on commutation factors.
- It was always the Scheme Actuary's duty to take note of such considerations when providing advice to the Trustee.
- It was the Trustee's duty to consider the Scheme Actuary's advice – but it could adopt such advice or reject it.
- As was outlined in the formal response of 6 November 2018, TPT was satisfied the Scheme Actuary and the Trustee had faithfully carried out their duties regarding the setting of commutation factors.

21. On 31 January 2019, Mr T wrote to TPT to appeal its Stage 1 IDRP response, making the following points:-

- The fact that other UK pension schemes have a considerable disparity does not make it right.
- The 'Risk Alert' is too easily set aside once it is brought to the attention of the Trustee. The modest improvements in the commutation factors do not mitigate this risk.
- The commutation lump sum ratio listed in the Appendix to the illustration was still only 60% of the transfer value ratio.
- The point about a survivor's pension is irrelevant since the figures provided to him make allowance for this by offering a Member's pension with no provision for a survivor's pension.
- The Scheme Information Form clearly states that the 'Tax-Free Cash Basis' is 25% of the value of your benefits' when this was not the case.

22. On 29 March 2019, following a further request for retirement quotations, TPT sent Mr T a letter outlining his current pension options as follows:-

- Estimated transfer value of defined benefits: £246,607.42

- Option 1 Full pension of £9,461.60, a survivor's pension, no PCLS.
- Option 2 PCLS of £44,233.37, pension of £6,635.01, a survivor's pension.
- Option 3 Enhanced pension of £10,250.06, no survivor's pension.
- Option 4 Enhanced PCLS of £47,919.47, reduced enhanced pension of £7,187.92, no survivor's pension.

23. On 3 April 2019, TPT provided its Stage 2 IDRPs response to Mr T which rejected his appeal, responding to his points as follows:-

- Mr T's opinion was noted, but the fact that there is disparity between transfer values and commutation factors across the pension industry indicates that the Scheme is not out of line with the wider industry. This demonstrates the Trustee's decision making is in line with that of other pension scheme trustees.
- The 'Risk Alert' is one of a number of such alerts, which are published to help ensure Scheme Actuaries give appropriate advice. The risk this particular alert seeks to mitigate is not that pension scheme trustees do not make improvements to commutation factors, but that the Scheme Actuary has not given consideration to the points numbered 1-6 in that alert. Accordingly, provided the Scheme Actuary has done so, and the Trustee has considered that advice (which it has) then the requirement under the Scheme Rules, and wider law, has been satisfied. The Trustee does not agree that the 'Risk Alert' is intended to lead to action as regards the commutation factors ultimately agreed.
- Since its previous consideration of Actuarial Advice, the Trustee has again reviewed the factors and has agreed to a further improvement to the commutation factors.
- Where the Scheme Information Form states that a member may take 25% of the value of their benefits as tax-free cash, this is on a calculation basis set in legislation, but using Scheme commutation factors therefore results in a different figure to 25% of the transfer value.
- The Trustee enclosed a revised illustration using the improved commutation factors, dated 16 February 2019, and showing the latest estimated transfer value so that Mr T could compare commutation and transfer value ratios.

24. On 3 February 2021, TPT issued further illustrations showing Mr T's pension options, but there was an omission in respect of additional survivor's pension.

25. On 17 February 2021, TPT sent a further letter correcting its previous letter which had stated a quote could not be given for a 100% spouse's pension. It outlined the two pension options offering an additional 50% survivor's pension currently available as follows:-

- Estimated transfer value of defined benefits: £300,062.84
- Option 1 Full pension of £9,470.80, 100% survivor's pension, no PCLS.
- Option 2 PCLS of £49,215.65, pension of £6,534.24, 100% survivor's pension.

26. Mr T's position:-

- He remains of the view that the commutation factors used in calculating a PCLS are unfairly low and should be more closely aligned to the factors used in calculating a transfer value.
- He believes he is entitled to a PCLS calculated in line with the same factors applicable to a transfer value.

27. Respondent's position:-

- It is obliged under the Scheme Rules to take Actuarial Advice when determining the conversion of pension to lump sum.
- It now considers commutation factors on an annual basis.
- It is not required to warrant that the commutation factors in use accurately reflect the amount of pension given up in favour of a PCLS.
- It had explained to Mr T why the factors used in commutation for a PCLS are different to those used to calculate transfer values.
- It does not accept Mr T's assertion that it should be taking measures to ensure ratios for producing the PCLS are improved to bring them into line with transfer value multiples.

## **Adjudicator's Opinion**

28. Mr T's complaint was considered by one of our Adjudicators who concluded that no further action was required by TPT or by the Trustee. The Adjudicator's findings are summarised below:-

- While a PCLS is broadly limited to the lower of 25% of a member's uncrystallised pension rights and 25% of their lifetime allowance, the Trustee was not obliged to pay Mr T a PCLS equal to 25% of his overall benefits, as well as paying him those benefits.
- The Trustee has a duty to ensure it can pay all guaranteed benefits due to all members now and in future. As a result of this duty, the Trustee has the discretion to decide what factors it will apply for both commutation and transfers, having obtained actuarial advice.



- It is for the Trustee to run the Scheme for the benefit of all members, in keeping with the Rules and legislation.
  - Actuarial advice had been sought when deciding the Scheme's commutation factors and transfer basis.
  - There was nothing inherently unfair in the Trustee's assertion that Mr T could take a transfer if he wanted a larger PCLS than was on offer through commutation of his Scheme benefits.
29. Mr T did not accept the Adjudicator's Opinion and the complaint was passed to me to consider. Mr T provided his further comments which do not change the outcome. I agree with the Adjudicator's Opinion and note the additional points raised by Mr T, which are summarised below as follows:-
- There are two elements to his complaint:-
    - Whether the formula used for converting pension into cash and the ratio of 26:1 for a transfer value compared to 15.3:1 for a PCLS is unreasonable.
    - The second issue is the proportion of the pension given up to produce a PCLS, which Mr T calculates at 31% of the pension being given up to fund the PCLS whereas he would have expected 25%. He does not believe this can be right.
30. Mr T also said that:-
- The Adjudicator's figures used in paragraphs 17, 20 and 35 of her Opinion were irrelevant because he had used figures excluding the effect of the survivor's pension.
  - He expected more weight to have been given to the Institute of Actuaries' Risk Alert.
  - The issues raised potentially affect many prospective pensioners.

### **Ombudsman's decision**

31. An employer offers employees the opportunity to provide for their retirement by saving into a pension plan. In this case, the employer offers a defined benefit pension scheme into which both the employer and the individual members contribute at a rate which is set down in the Scheme Rules. In return for these contributions, members are offered a defined benefit pension at retirement, based upon their final salary.
32. Employers and the Trustees who run occupational pension schemes on their behalf have a duty to ensure that pension schemes can continue to provide a benefit at retirement for all members, in accordance with the rules of a particular scheme, now and in the future.

33. In doing so, the Trustee of any pension scheme must consider the scheme's ability both to maintain the benefits that have been promised to an individual member, such as Mr T, throughout retirement, and ensure in doing so that it can pay the benefits that have accumulated for current and future Scheme members.
34. In this case, the dispute centres around the difference between actuarial factors the Trustee uses to calculate transfer values and those used to commute pension benefits in return for a PCLS. I have considered all of the points raised by Mr T and I understand his belief that the disparity between the two relevant factors is unfair.
35. However, my role is not to make decisions on what is fair and reasonable. Rather, it is limited to a consideration of whether, or not, the Rules and any relevant legislation have been followed properly by the Trustee in producing the options open to Mr T at retirement.
36. The Rules confirm that the Trustee must obtain regular actuarial valuations of the Scheme from an actuary appointed by the Trustee, in accordance with Section 47 of the Pensions Act 1995.
37. The Trustee has confirmed it takes regular actuarial advice, and considers the various Risk Alerts and other guidance available from the Institute of Actuaries before setting its commutation or transfer value factors.
38. The Rules state that a Member entitled to a defined benefit pension may give up pension for a lump sum up to the maximum permitted under Part 4 of the Finance Act 2004.
39. Further, the Rules state that "the Trustee will convert pension to lump sum on a basis it decides after considering Actuarial Advice."
40. There is nothing in the Scheme Rules that offers the opportunity for Mr T to negotiate the factor used either in commutation for a PCLS or in that used for a transfer value.
41. Having considered the Rules, I am satisfied that the Trustee is acting within its powers when it decides what factor to apply in calculating the PCLS.
42. Mr T can choose from any of the options offered to him under the Scheme, or he can take a transfer out of the Scheme if he wishes to utilise the potential opportunity to maximise his PCLS. He cannot obtain a PCLS based on the rate applicable to a transfer value.
43. I do not uphold Mr T's complaint.

**Anthony Arter**

Pensions Ombudsman  
24 May 2021