

## Ombudsman's Determination

|             |  |
|-------------|--|
| Applicant   | Dr Y   |
| Scheme      | BAE Systems Pension Scheme ( <b>the Scheme</b> )                   |
| Respondents | BAE Systems Executive Pension Fund Trustees ( <b>the Trustee</b> ) |

## Outcome

1. I do not uphold Dr Y's complaint and no further action is required by the Trustee.

## Complaint summary

2. Dr Y has complained that his Cash Equivalent Transfer Value (**CETV**) is too low. He says:-
  - He is unable to exercise his option of purchasing an annuity through the open market without suffering a financial loss.
  - A letter he received in June 2018 provided him with confusing information regarding his deferred status.
  - There was a delay in receiving a response to his complaint appeal.

## Background information, including submissions from the parties

3. Dr Y joined the Scheme on 2 January 2000, and later opted out of it, becoming a deferred member on 1 November 2017. The Scheme is administered by Equiniti (**the Administrator**).
4. On 15 March 2018, Dr Y informed the Administrator that he intended to retire on 1 June 2018 and requested an illustration of a CETV. Dr Y's Scheme Normal Retirement Age (**NRA**) was 10 November 2017, when he reached age 65. Dr Y has a defined benefit (**DB**) pension with the Scheme plus an Additional Voluntary Contributions (**AVCs**) arrangement.
5. On 24 April 2018, the Administrator sent Dr Y a deferred benefit information pack outlining his benefits for a retirement date of 1 June 2018. This showed a CETV of £390,184.71 calculated on 24 April 2018 of which £17,895.71 was in respect of his AVCs.

6. The Administrator sent Dr Y another deferred benefit information pack on 26 April 2018. This set out a pension with the Scheme of £17,523.60 (excluding AVCs).
7. Dr Y says his preferred option, of a non-escalating annuity with no provision made for a spouse, was not available under the Scheme. The Scheme only offered an escalating pension with a provision for a spouse's pension. He wanted to exercise his open market option in order to obtain an annuity which was better suited to his individual circumstances than the one available from the Scheme.
8. On 2 May 2018, Dr Y complained to the Administrator that the CETV was too low. He deduced this by obtaining a quotation from a financial services company for an annuity mirroring the Scheme benefits using the CETV he had been quoted. This resulted in an annuity of £11,180 per annum. Dr Y asserted that the CETV was incapable of purchasing a similar benefit on the open market and was therefore not actually equivalent.
9. On 12 June 2018, Dr Y raised a complaint using the Scheme's internal dispute resolution procedure (**IDRP**). He was unhappy with the CETV quoted to him and felt it did not represent an equivalent value of his benefits in the Scheme.
10. Towards the end of June 2018, Dr Y received a letter from the Administrator. It explained that as he had not elected to defer his pension beyond NRA, his pension would be put into payment. Dr Y was concerned by this and spoke with the Administrator. He asserted that he had already elected to defer his pension at NRA. The Administrator said that it would confirm in writing his status as a deferred member. Dr Y did not receive a letter and became increasingly distressed about the situation. He contacted the Administrator on several occasions receiving conflicting information.
11. On 22 July 2018, Dr Y eventually received definitive confirmation from the Administrator regarding his deferred status.
12. On 3 August 2018, the Trustee provided its stage one IDR decision. It said that the Scheme's CETV calculation methods were set by the Trustees based on actuarial advice. These methods were consistent with legislation and properly reflected the characteristics of the Scheme. The Trustee did not agree that the CETV from the Scheme was too low. It said it would expect that it would cost more on the open market to purchase benefits equivalent to those provided by the Scheme because:-
  - The annuity provider has to be confident it can provide the annuity from the purchase price, that is, the CETV. Once the purchase price has been paid, there is no opportunity for the provider to seek additional funds if the cost of providing the annuity proves to be higher than expected. But if a member stays in the Scheme, and it costs more to provide their benefits, the funds in the Scheme can generally be topped up.

- The annuity provider will build in profit margins and expense loadings which means the cost of providing the annuity is higher than it would be within the Scheme.
  - The CETV is calculated based on the expected investment return on the Scheme's assets. Assets held by the Scheme are higher risk than those an annuity provider would be able to hold for regulatory reasons. An annuity provider therefore needs to charge more to provide the same benefit as there is a limit to the investment return, they can expect to receive on the same money. (**Rationale one**)
13. The Trustee explained that Dr Y's preferred benefit option, to have a level pension with no spouse's benefit, was not available under the Scheme. It said that its duty was to ensure that benefits were calculated in accordance with the Scheme Rules. There was no provision under the Scheme Rules to provide him with benefits tailored to his circumstances, as he had requested.
14. Dr Y was unhappy with the Trustee's response and submitted a request for a stage two IDR decision. He made the following points regarding the CETV calculation:-
- The calculation basis used by the Trustee assumed there is a 50:50 chance of the cost of securing benefits under the Scheme being higher or lower. When he reviewed the history of actuarial valuations going back to 5 April 2002, there had been a requirement for deficit contributions to be paid at every actuarial valuation.
  - Profit margins and expense loadings are built into insurer's costs, but they are not factored into CETVs. The fees of the Scheme Administrator should be taken into account.
  - Although the Scheme invests in asset classes which have a higher degree of risk in anticipation of higher returns, the results of the history of actuarial valuations has proven this not to be the case and so the cost of providing benefits has consistently been underestimated.
  - He had compared the projected annuities generated by his own computer program which tracks 15-year gilts and corresponding annuity rates, with annuities on the open market. He had concluded that the insurer's profit margins were not excessive.
  - If the Scheme was not obliged to offer members a pension in their preferred format the CETV should ensure that it represents a fair value.
15. Dr Y also complained about the letter he received in June 2018, from the Administrator, which explained that as he had passed his NRA his pension must now be put into payment. He said there were delays caused by the Administrator in confirming his deferred status.

16. On 7 January 2019, the Trustee provided its stage two decision agreeing with the arguments put forward in the stage one response. It said that Dr Y's CETV was calculated in accordance with the basis recommended by the Scheme Actuary, taking into account legislative requirements and the Scheme Rules. The Trustee made the following comments about the points Dr Y put forward:

"The fact that deficit contributions have been required at each valuation does not necessarily imply that assumptions have not matched experience. It is not unusual for recovery plans to stretch over the course of three or more valuation cycles, in which case deficit contributions would continue to be required even where experience had precisely matched assumptions. The continuous existence of a deficit also does not mean that asset returns (or any other assumption) have underperformed expectations – the chief cause of the deficit currently present is not asset underperformance but steep declines in long term interest rates...

Under regulations, the Trustee is permitted to allow for the administrative expenses of calculating and processing transfers by deducting these from the CETV figure itself. The Trustee does not do this on the basis that it is expected to be broadly offset by future administrative savings should a member leave the Scheme...

The Trustee does not discriminate between members in the CETV calculation on the basis on anticipated life expectancy (which is correlated to affluence and could therefore in theory be built into the CETV calculation process through rating factors such as salary, post code or medical history). Using this rationale, if a member disclosed their poor health this could lead to their life expectancy being reduced and thus the best estimate cost of providing a benefit being lower than the average for Scheme members. Instead, CETVs are based on the expected average life expected for Scheme members. The basis on which CETVs are calculated represents fair value." (**Rationale two**)

17. The Trustee also addressed Dr Y's concerns about the letter he received in June 2018. It said that the letter was sent in error and does not reflect the high standard the Administrator endeavours to provide. It also acknowledged that there was a delay before the Administrator was able to provide confirmation to him of his deferred status in writing. The Trustee recognised that Dr Y may have suffered some distress and inconvenience because of the delay and agreed to pay him £500.

## **Dr Y's position**

18. Dr Y says:-

- The CETV of £372,289 is too low and he is in essence "trapped" in the Scheme. He says that he cannot exercise his open market option without suffering a financial loss.

- The letter he received in June 2018, which said his pension would be put into payment caused him a considerable amount of distress and inconvenience.
  - The delays in receiving a response to his stage two IDRPs appeal.
19. Under the Scheme's IDRPs all stage two responses are to be considered by the discretionary committee. If the discretionary committee is unable to respond within the prescribed two-month period, an interim response may be issued to the member giving the reason for the delay and an indication of when they would expect to receive a response.
20. The Trustee has said it received Dr Y's stage two appeal in response to the stage one decision on 5 September 2018. The Trustee wrote to Dr Y confirming receipt of his appeal and informed him that it would be considered at the next discretionary committee meeting on 6 December 2018. The letter informed Dr Y that once the meeting had taken place and a formal confirmation of the decision had been made it would write to him.
21. The outcome was decided on 7 December 2018. On 21 December 2018, the Trustee emailed Dr Y informing him that due to the office closure over the Christmas period a response would be issued to him as soon as possible after 7 January 2019. The stage two response was subsequently provided to Dr Y on 7 January 2019.

## Adjudicator's Opinion

22. Dr Y's complaint was considered by one of our Adjudicators who concluded that no further action was required by the Trustee. The Adjudicator's findings are summarised below:-
- In order to comply with The Occupational Pension Schemes (Transfer Values) Regulations 1996 (**the Transfer Regulations**), and Pension Schemes Act 1993 (**the 1993 Act**) the Trustee must calculate the CETV of a member's benefits with the assistance of the Scheme Actuary, using a prescribed method and underlying assumptions which are reviewed on a regular basis. In Dr Y's case, the Trustee has confirmed that his CETV was calculated in accordance with the basis recommended by the Scheme Actuary, taking into account legislative requirements and the Scheme Rules.
  - The Adjudicator was satisfied that the CETV provided to Dr Y in April represented what the Trustee considered to be a fair value of the benefits he had accrued in the Scheme and the calculation would have taken into consideration many factors such as age, salary and length of pensionable service.
  - The Adjudicator considered Dr Y's concerns about the CETV being incapable of purchasing a similar benefit on the open market. He was satisfied that the Trustee provided valid reasons in Rationale one and Rationale two in its IDRPs

response. The Adjudicator said that in some cases the benefits provided in a DB scheme are greater than those available on the open market. There are a variety of factors and market conditions which would affect the value.

- The Trustee has recognised that the letter sent in June 2018 was sent in error. It also acknowledged that there was a significant delay before confirmation of Dr Y's deferred status was sent to him in writing. Whilst the incorrect information and delays may have caused Dr Y some distress and inconvenience, the Trustee has acknowledged and apologised for its error. It provided Dr Y with confirmation of his deferred status and paid him £500 for the distress and inconvenience caused. The Adjudicator said that the Trustee addressed all of Dr Y's concerns and he was unable to see why any further award was warranted.
- Dr Y raised concerns about the delays in receiving a response to his stage two IDRPs appeal. He says that this caused him further distress and financial loss. The Adjudicator said that Dr Y was provided with regular updates and a clear indication on when he should expect to receive a response. The Trustee provided valid reasons in accordance with the Scheme's IDRPs. The Adjudicator also said that Dr Y did not provide any evidence to show how this issue caused him financial loss.
- In the Adjudicator's opinion, Dr Y has not suffered an actual financial loss as he should only receive the benefits that he is entitled to, correctly calculated in line with the Scheme Rules. The Trustee has acted in accordance with the Transfer Regulations which it is obligated to follow under the Scheme rules and by law.
- The Adjudicator accepted that Dr Y suffered some distress and inconvenience in regard to the letter he incorrectly received in June 2018 but said the £500 the Trustee offered is reasonable and in line with the awards given in similar cases.

23. Dr Y did not accept the Adjudicator's Opinion and the complaint was passed to me consider. Dr Y and the Trustee provided further comments as summarised below.

### **Summary of Dr Y's further comments**

- Dr Y says that the Trustee uses two methods to determine the cost of providing a pension. He says it uses one method for calculating a CETV when a member wishes to transfer their Scheme pension out of the Scheme and another method for when a member chooses to take an income using their AVCs within the Scheme. Dr Y says that the two calculation methods provide very different CETVs and both cannot be correct. He referred to the two deferred benefit information packs he received on 24 and 26 April 2018:

**Method one** (Benefit information pack dated 24 April 2018)

“The Scheme’s annual pension is £17,524.00 and they have determined that the cost of providing this benefit is: CETV of £372,289.00 This amounts to a yield of 4.707%”.

**Method two** (Benefit information pack dated 26 April 2018)

“Using factors provided by the Scheme Actuaries the Scheme has calculated the pension that can be provided by an AVC of £17,895.71: Pension of £563.88 annually. This amounts to a yield of 3.151%.”

**Table provided by Dr Y which shows the differences in fund yields**

|                            | Fund Value or CETV (£) | Fund Benefit (£ per annum) | Fund Yield (= Fund Benefit/ Fund Value) (%) |
|----------------------------|------------------------|----------------------------|---|
| BAE Systems Scheme         | 372,289 (1)            | 17,524 (2)                 | 4.71 %                                      |
| AVC                        | 17,896 (1)             | 564 (2)                    | 3.15 %                                      |
| Financial services company | 372,289                | 11,180                     | 3.0   |

- Dr Y believes that method two represents a realistic valuation of providing pension benefits. He believes that this is consistent with yields offered by other pension providers. Dr Y says that the yield is far less for the AVC pension as seen in method two and should be used to calculate his CETV.
- Dr Y says that he never made a request for the Scheme to provide him with benefits tailored to his individual circumstances. Instead, he says the Scheme should offer the actual equivalent value to allow members to exercise their free market option.
- Dr Y argued that the Adjudicator did not provide any comments about the actuarial reviews and deficit contributions in his findings.
- Dr Y says that the Adjudicator misinterpreted the Schemes IDRPs. He says that section 7 of the Schemes IDRPs states:
 

“Applications for the discretionary committee to reconsider the matter will be acknowledged within 14 days and a full written response will be provided no later than two months after an application is received”. (the Time limit)
- Dr Y reiterated that the Trustee received his stage two appeal on 5 September 2018. However, he did not receive its full written response until 7 January 2019 which he says is not acceptable.

- Dr Y disagreed with the Adjudicators comments about him not providing any evidence of financial loss. He says that had he received a fair and reasonable CETV he would have started to receive his pension on 1 June 2018. Alternatively, the pension he would have received from the Scheme would have commenced on that date and paid £18,087.48 per annum, including his AVC. Dr Y says that he has not been able to take any pension while he has been disputing the CETV and has had to rely on his savings which cost him approximately £3,014.00.

### Summary of the Trustee's further comments

- The CETV is determined by the Scheme Actuary based on various factors such as the date Dr Y left the Scheme, his age, inflation and mortality rates.
- The AVCs do not form part of the CETV. They are not guaranteed and are subject to change.
- The Scheme does not calculate CETVs in two different ways. The differences between the pension deriving from the AVCs and pension deriving from the main pension arose in this case for the following reasons:

“AVCs are voluntary contributions designed for members to be able to top up retirement benefits. These are separate member specific benefits to the defined benefits in the Scheme. They are not guaranteed or defined from the outset. As such, these contributions are treated differently to the defined benefits of the Scheme...

Members can either use their AVCs as cash at retirement or to buy an annuity (pension) in the Scheme or in the open market...

To calculate the pension that can be bought a factor is used which is intended to mirror, broadly, the market annuities but with fewer margins for mortality, expenses and profits that an insurer would include. This means that the factors are more favourable to the member than typical market rates offered by insurers. The Scheme pension is derived as prescribed by the Scheme Rules.” (**Rationale three**)

- The Trustee added the pension quoted in the benefit pack dated 26 April 2018 was calculated with a retirement date of 1 June 2018. However, the CETV was calculated using pension with an effective date of 23 April 2018. It said that for the calculation of a CETV where a member is over NRA, it is assumed that the member retires immediately, and their pension is put into payment at that date. Therefore, there may be a slight difference in pension as the effective dates of the calculations are different.

24. These comments do not change the outcome and I agree with the Adjudicator's Opinion. I will therefore only respond to the key points made by Dr Y for completeness.



## Ombudsman's decision

25. Dr Y contends that the Trustee calculates CETVs in two different ways. He believes that method two should be used to calculate his CETV as this provides a smaller yield and will produce a higher CETV. However, the CETV and Scheme pension have been calculated on different dates, so the yield he has calculated is not accurate. The pension has received an additional month's late retirement uplift because it was calculated in the next calendar month. Therefore, the pension is higher than it would have been if it was calculated on the same date the CETV was calculated.
26. The Trustee, after seeking advice from the Scheme Actuary, explained that the Scheme does not calculate CETVs in different ways. It said that AVCs do not form part of the CETV and provided the reasons for the differences in Rationale three.
27. Having reviewed the reasons provided by the Scheme Actuary in Rationale three, I agree that it has appropriately addressed Dr Y's concerns and explained the reasons for the difference. Broadly speaking AVCs should not be compared to DBs as they are treated differently.
28. The Scheme provides DBs. This means that the service and salary are used to calculate the pension payable at retirement. If a member wants to transfer the Trustee must calculate a CETV. Essentially, this is the cost to the Scheme for providing the pension due at the members retirement date or at the point the CETV is calculated, if after the NRA. This value must be calculated in accordance with the Transfer Regulations and the 1993 Act but is influenced by a number of factors such as age, market conditions and the date the member left pensionable service. In contrast, AVCs are a Defined Contribution (**DC**) benefit. This means that a set level of contributions is paid and invested which create a pot of money, or a fund, the value of which could go up or down depending on investment performance. The transfer value of AVCs is the value of the fund at the point it is transferred, if the AVCs are taken as an income the level of income payable is dependent on the value of the fund and annuity rates available at retirement. These are very different calculations which are not comparable. They are dependent upon different factors and subject to different regulations.
29. I can understand why Dr Y may think that the Scheme has not offered him a CETV that is of equivalent value to his Scheme benefits to enable him to exercise his free market option. However, I agree with the Adjudicator that the CETV provided to Dr Y in April represented what the Trustee considered to be a fair value of benefits he accrued in the Scheme. In accordance with the Scheme Rules and pension legislation, Dr Y's CETV has been calculated using a prescribed method provided by the Scheme Actuary.
30. Dr Y says that the Adjudicator did not provide any comments on the Actuarial reviews. However, the Adjudicator considered the information provided by the

Trustee under Rationale two. He was of the opinion that the Trustee provided sufficient and valid reasons to explain why there had been a continual deficit. I agree with the Adjudicator, having considered the Trustee's comments, and I am satisfied it has provided a reasonable response. It is not unusual for DB Schemes to have a deficit due to declines in interest rates. The fact that the Scheme has a deficit does not mean that Dr Y's CETV has been calculated incorrectly.

31. I have looked at section seven of the Scheme's IDR process. Under the Time Limit it states:

"If a full written response is not provided within two months, an interim reply will be sent to explain the reasons for the delay and give an indication of when a decision may be expected."

32. I agree with the Adjudicators findings. the Trustee provided regular updates to Dr Y, as well as a clear indication on when he should expect to receive a response. The Trustee told Dr Y that his appeal would be considered at the next discretionary committee meeting which was not until 6 December 2018. It also informed him of the office closure over the Christmas period. I note that Section 50, 5(a) of the Pensions Act 1995, states that a response must be provided within a reasonable timeframe. In its code of practice, Code 11, under reasonable time periods the Pensions Regulator expects that a decision will be made for each stage of a dispute within four months of receiving the application. I am satisfied that the Trustee has acted in accordance with the Scheme's IDR process and the governing legislation.

33. Dr Y says he has suffered a financial loss of £3,014.00. However, I would not consider this to be a financial loss as Dr Y chose not to take his benefits on 1 June 2018 and instead pursued his complaint through the Scheme's IDR process. If there is a financial loss it is as a result of his decision not to take his benefits and pursue the complaint rather than any action of the Trustee. I am satisfied that the Trustee acted in accordance with the Scheme's IDR process and provided him updates on when he should expect to receive a response. Despite this, Dr Y decided to wait until he received the Scheme's IDR response before taking his benefits.

34. In summary, Dr Y has not suffered an actual financial loss, he is only entitled to the correct level of benefits, calculated in accordance with the Scheme Rules. The CETV issued to Dr Y represented what the Trustee considered to be a fair value of the benefits Dr Y had accrued in the Scheme and was calculated in accordance with actuarial advice provided by the Scheme Actuary.

35. I would not have made an award for distress and inconvenience in this case. Although, there was a letter sent in error and a delay I do not find that either merits an award, the starting point of which is that there has to be a significant level of distress and inconvenience. I can understand Dr Y's annoyance with regard to the error and delay, but I believe the real issue was not being able to discount the value of a spouse's pension. It is obviously, frustrating for Dr Y, in not being able to obtain a

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CETV which would provide an alternative benefit uplift, however, it is not an issue for which I will direct that a distress and inconvenience award be paid.

36. I do not uphold Dr Y's complaint.

**Anthony Arter**

25 October 2019  
Pensions Ombudsman

## Appendix

### Pensions Act 1995

#### Resolution of disputes

##### 50 Requirement for dispute resolution arrangements

(1) The trustees or managers of an occupational pension scheme must secure that dispute resolution arrangements complying with the requirements of this section are made and implemented.

(2) Dispute resolution arrangements are arrangements for the resolution of pension disputes.

(3) For this purpose a pension dispute is a dispute which—

(a) is between—

(i) the trustees or managers of a scheme, and

(ii) one or more persons with an interest in the scheme (see section 50A),

(b) is about matters relating to the scheme, and

(c) is not an exempted dispute (see subsection (9)).

(4) The dispute resolution arrangements must provide a procedure—

(a) for any of the parties to the dispute mentioned in subsection (3)(a)(ii) to make an application for a decision to be taken on the matters in dispute (“an application for the resolution of a pension dispute”), and

(b) for the trustees or managers to take that decision.

(4A) The dispute resolution arrangements may make provision for securing that an application for the resolution of a pension dispute may not be made to the trustees or managers unless—

(a) the matters in dispute have been previously referred to a person of a description specified in the arrangements (“the specified person”) in order for him to consider those matters, and

(b) the specified person has given his decision on those matters,

and for enabling the specified person's decision to be confirmed or replaced by the decision taken by the trustees or managers on the application, after reconsidering those matters.

(5) Where an application for the resolution of a pension dispute is made in accordance with the dispute resolution arrangements, the trustees or managers must—

(a) take the decision required on the matters in dispute within a reasonable period of the receipt of the application by them, and

(b) notify the applicant of the decision within a reasonable period of it having been taken.

## **The Pensions Regulator - Code 11 Dispute resolution - reasonable periods**

### **The reasonable time periods**

11. The Pensions Regulator expects that a decision will be made on a dispute within four months <sup>6</sup> of receiving the application.

12. Applicants should be notified of the decision usually no later than 15 working days <sup>7</sup> after the decision has been made.

13. Trustees or managers may choose to adopt a procedure with shorter decision and notification times if they wish. For example if they want to continue to operate a two-stage procedure in accordance with the time limits prescribed under previous legislation <sup>8</sup>.

14. The Pensions Regulator recognises that the circumstances of each dispute are different. For example, in some cases it will be possible to respond to an application sooner than the reasonable time given. Where this is the case, we would not expect there to be a delay in giving the decision to the end of the reasonable period.

15. We also recognise that the circumstances of a particular dispute may mean that it is not possible to complete the procedure within the timeframes outlined in this code of practice. For instance, where the dispute involves unusually complex and labour intensive calculations or research, or delays occur that are outside the control of the trustees or managers (or 'specified person'), for example because they need to obtain medical evidence.

16. Trustees or managers must be happy that the time taken to provide a decision is appropriate to the situation and that the necessary action has been taken to try and meet the reasonable time periods. The Pensions Regulator may call upon trustees or managers to demonstrate the propriety of the time taken.