THE DEPARTMENT FOR WORK AND PENSIONS

RESPONSE TO THE REPORT BY THE PARLIAMENTARY OMBUDSMAN

"TRUSTING IN THE PENSIONS PROMISE"

June 2006

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Introduction

i. On Wednesday 15 March 2006 the Parliamentary Commissioner for Administration (the Ombudsman) published her report 'Trusting in the pensions promise'. The report was presented to Parliament under section 10 (3) of the Parliamentary Commissioner Act 1967. The report considered the circumstances in which final salary occupational pension schemes were wound up underfunded and the role of Government in this regard.

ii. In the first 146 pages of her report the Ombudsman sets out in detail a record of some of the key background to the winding up of certain final salary occupational pension schemes. This response adds to that, giving relevant context to some of the events.

iii. The Government wishes to place on public record that it has very great sympathy for those who have lost substantial sums of money due to their scheme being unable to meet its pension commitments. No one could deny the very real distress many people have experienced as a consequence.

iv. The Government was grateful to the Ombudsman for providing it with advance warning of her findings and recommendations. The Government first saw these, in draft, as early as December 2005. This meant that it was possible to consider the issues raised both seriously and carefully for some three months before they were finalised.

v. The Ombudsman asked the Government to respond to the findings and then to respond to her recommendations within two months of publication of her report. The Government gave the Ombudsman's report very careful consideration, but could not agree with its findings and explained its reasons for this to the Ombudsman. In short, it does not believe that the report makes the case that the Government is responsible for the losses incurred. Given that the Government could not agree the findings of maladministration, it considered that any delay in responding to the recommendations could only have served to raise false hopes amongst the complainants concerned.

vi. On Wednesday 15 March the Government ensured that nothing fresh was contained in the published report that might require a review of its position. As nothing new was identified compared to earlier versions a letter was sent to the Ombudsman by the Permanent Secretary, giving the Department's formal response. In addition, a written statement was laid in both Houses of Parliament. The following day (Thursday, 16 March 2006) in an oral statement to the House of Commons (repeated in the House of Lords by Lord Hunt) the Secretary of State undertook to

issue in the next few weeks, a “proper, full and formal response”. The Secretary of State also undertook to “set out the details of our costings when we produce our fuller response”.

vii. This paper fulfils these undertakings to explain more fully to Parliament the basis for the conclusions the Department came to in relation to the Ombudsman’s report. These reasons were explained to the Ombudsman during the course of her investigation and in response to her draft reports.

The first section describes some of the background to the pensions system, examines some of the points made by the Ombudsman in her report and reiterates the Government’s position on the Ombudsman’s findings.

The second section and the accompanying Annex sets out the Government’s response to the Ombudsman’s recommendations and provides the Government’s estimate of the cost of implementing the Ombudsman’s proposals.

The third section summarises the Government’s conclusion and actions already taken, and being taken, by the Government to protect pension scheme members.

Section 1: Background and Government’s Response to the Ombudsman’s Findings

The Report’s Findings

1. The Ombudsman made three findings of maladministration. The first concerned information issued by the Department. She found:

> *“that official information - about the security that members of final salary occupational pension schemes could expect from the [Minimum Funding Requirement] MFR provided by the bodies under investigation - was sometimes inaccurate, often incomplete, largely inconsistent and therefore potentially misleading, and that this constituted maladministration.”*

The Ombudsman also considered that the Department should have reviewed the official information which was publicly available in 2001. Finally, the report says that there is insufficient evidence to explain the rationale behind the Government’s decision in 2002 to amend the MFR calculation.

2. Further the report finds that this maladministration was *“a significant factor in creating the environment in which....losses were crystallised.”*

Background

Salary-related Occupational Pension Schemes

3. Occupational pension schemes are voluntary arrangements set up by employers to offer pension benefits to their employees. Many are salary-related: that is the pension payable is related to the employee's salary (whether close to their retirement or averaged over their working life) and the length of time the person works for that employer and is a member of the scheme. Many offer ancillary benefits, such as death benefits for a surviving dependant.

4. Most such schemes are funded by contributions from employees (normally a fixed percentage of a person's salary) and the employer, who undertakes to meet the balance of the scheme costs. These funds, along with the returns from investing them, are used to pay the pensions as they become due.

Trusts and Trustees

5. Occupational pension schemes are generally set up as trusts. This allows them, and both the employer and the employees, to qualify for tax advantages and also ensures that the assets of the scheme are held separately from the company. A trust is an arrangement whereby a third party (the trustees) holds assets for the benefit of the beneficiaries of the trust (the members of the pension scheme). The trustees have a number of duties in relation to the scheme and its members, including ensuring that the assets of the pension scheme are invested prudently and that the scheme is administered properly.

Comment: The law on wind-up over-rides trustee powers. Once the scheme starts to wind-up, the law dictates how the assets are to be divided and the requirements to buy annuities. These become effectively government-directed funds. The law requires non-pensioner members' own contributions to be used to fund pensions for pensioner members of the scheme, which can leave them with no pension at all. This change to the law was made in 1997, but members were not told abot it. Before 1997, trustees had discretion to divide assets more fairly.

6. As the Occupational Pensions Regulatory Authority (Opra)[1] said:

***Guide for Pension Scheme Trustees (1997)*:**
"Your role as a trustee is very important and responsible. The members of the scheme have placed their trust in you to ensure that their promised benefits will be paid. They will be looking to you to ensure that the scheme is administered efficiently and honestly. It is therefore very important that you understand and develop your knowledge."
Comment: The trustees did administer the schemes honestly and in line with MFR legislation.. However, the OPRA guide for trustees, published in 1997, was actually wrong about the MFR. It misled trustees, who then misled members into believing 100% MFR funding meant full pensions would be paid on wind-up. The booklet was only issued correctly in 1999, but OPRA did not make sure all those who received the incorrect information received notification of the error.

7. Complying with the relevant legislation is only the beginning of the trustees' duties. Further duties are set out in the trust deed. These normally include the ability to decide the investment strategy, amend the rules of the scheme and decide the level of contribution commonly in agreement with the employer. The trust deed may specify that some powers may only be used with the consent of the employer.

Government Involvement

8. The Government does not, in general, guarantee the security of private sector, occupational pension schemes. **Comment: Then why did the DWP and FSA tell members that these types of pensions were 'safe', 'protected by laws' and 'guaranteed'.** They are governed by a combination of trust law (both legislation and precedent), tax law and pensions and employment legislation.

[1] The Occupational Pensions Regulatory Authority (Opra) was established from 6 April 1997 as a regulatory body with powers to monitor and enforce proper standards of administration in pension schemes in the UK. It was replaced by the Pensions Regulator in 2005.

9. The key legislation which is relevant to the issues raised by the Ombudsman is contained in the Pension Schemes Act 1993 and the Pensions Act 1995. Nothing in this legislation requires those responsible for pension schemes to ensure that their scheme is capable of paying all accrued rights in full at any time, regardless of what happens. Indeed it was made clear during the passage of the Pensions Act 1995 (see paragraph 31 below) that this was not possible either in practical or economic terms. **Comment: But Parliament was told that the MFR did actually protect accrued pensions, whatever happened to the employer. Pensioner benefits would be met with annuities and non-pensioners would get a transfer value equivalent to their accrued rights.**

The Minimum Funding Requirement (MFR)

10. The Ombudsman's report focuses heavily on the Minimum Funding Requirement (MFR) which came into effect on 6 April 1997 as a result of the provisions of the Pensions Act 1995. Prior to 1997 there were no legislative requirements about the level of assets an on-going scheme needed to hold - this was decided in accordance with the rules of their scheme. The 1995 Act built on these arrangements and ***provided scheme members with greater (but not total) protection by introducing the MFR***, which required private sector salary-related pension schemes to hold a minimum level of assets to meet their liabilities. **Comment: As a result of the interaction of the MFR and priority order on wind-up, non-pensioner members, especially those with very long service, actually had much *less* protection after the legislation than before. Also, members' state pensions were better protected before 1997 than after, because Guaranteed Minimum Pensions (replacement SERPS benefits) were taken back into the National Insurance pension system for the whole scheme, so members would not lose their entire state rights as has happened in many cases here. Furthermore, before the MFR legislation and 1995 Pensions Act changes, trustees had discretion as to how to divide up the assets. After 1997, the law took over and introduced the unfair priority order which gave full pensions to directors who took 'early retirement' at age 52, but no pension to workers with 40 years' service who were in their**

60's. It is almost impossible to imagine trustees, with discretion, dividing the assets in this way.

11. The MFR was never intended to require schemes to hold sufficient assets to ensure that all members' benefits could be fully secured should the scheme wind up (by purchasing annuities and deferred annuities from an insurance company). Instead it was intended to ensure that a scheme which was fully (ie 100%) funded on the basis of the MFR should have sufficient assets, in the event of it winding up, to protect fully pensions already in payment (by buying annuities), and to give younger members a cash amount which, if placed in a personal pension, would allow them a reasonable expectation - but not a guarantee - of achieving, at retirement, benefits equivalent to those lost. **Comment: This is exactly the point. The government failed to check what was happening to annuity rates and consider the security of members' pensions on wind-up.**

12. The funding position was to be tested by the scheme actuary on at least a three-yearly cycle. Where the scheme did not satisfy the MFR, it had a given time to make up the shortfall. Nothing prevented the scheme holding more assets than the MFR required. **Comment: The trustees could not force an employer to put in more than MFR, because the MFR was the statutory requirement – effectively the 'minimum' became the 'maximum'. Of course, trustees also were not aware of the inadequacy of the MFR and the risks of wind-up, since they often relied on the incorrect OPRA material to believe 100% MFR meant enough funding to pay full pensions. OPRA could not help trustees get more than 100% MFR funding out of an employer.** It was envisaged that an appropriate level of scheme funding would continue to be determined in accordance with the rules of the scheme, with the MFR being precisely that: a minimum.

13. The MFR was introduced on a phased basis from April 1997. To allow schemes and employers the time to move smoothly from their old system to the new requirement, transitional rules allowed trustees to obtain their first

MFR valuation in line with their scheme's existing (generally three-yearly) actuarial valuation cycle.

14. The MFR valuation involved the scheme actuary comparing the market value of the scheme's assets (stocks, shares, bonds etc) with a value placed on its liabilities (pensions in payment and, for those who had not retired, the value of the deferred benefits built up to the date of the valuation) on a specified date. The actuary followed guidance issued by the UK actuarial profession, and approved by Ministers, **Comment: The Secretary of State for Work and Pensions was responsible for approving and signing off on the MFR. It was in his power to change it and also to consider whether it was adequate** in carrying out these valuations. The actuary then provided a certificate to the scheme's trustees stating that either the scheme met the MFR or, if it did not, how much the shortfall was. This certificate, the format of which was laid down in legislation, emphasised to the trustees that meeting the MFR did not mean that the scheme could buy out fully all its liabilities. It said: **Comment: Many schemes had not even had an MFR valuation yet, before they actually started winding up, so the trustees would have no chance to read this small print anyway. Even if the note was in the report, it would not be something that member-nominated trustees would have been likely to spot, or even understand (see page 26, point 53 of Government statement)**

> ***"Note:***
>
> ***The certification of the adequacy of rates of contribution for the purpose of securing the meeting of the minimum funding requirement is not a certification of their adequacy for the purpose of securing the scheme's liabilities by the purchase of annuities, if the scheme wound up."***

(Occupational Pension Schemes (Minimum Funding Requirement) and Actuarial Valuations) Regulations 1996)

15. If the scheme's first MFR valuation showed a shortfall, the trustees generally had until April 2003 to bring the funding up to 90 per cent of the MFR level and until April 2007 to reach 100 per cent.

Altering the MFR test

16. The operation of the MFR was affected by economic and demographic factors such as increases in longevity, changes in yields from equities and other investments, and changes in the costs of buying annuities. **Comment: Another factor undermining the calculation of the MFR almost as soon as it was introduced, was the removal of dividend tax relief in 1997. The Government estimates that this raised £3.8bn a year which was taken out of pension funds and remitted to the Treasury.** It was therefore inevitable that it would fluctuate against its original objective. It was for this reason that the UK actuarial profession monitored the operation of the MFR test from the outset, with a view to recommending changes when they considered adjustments were needed to ensure that the operation of the MFR remained consistent with the original policy objective.

17. To put it simply, if the MFR test was operating above the required level it would be offering a higher level of security than intended and would have required the employer to put in more money than needed to meet the policy objective; if operating below the required level, it would be offering a lower level of security than intended and would not have required the employer to put in as much money as needed to meet the policy objective.

Official Information

18. Chapter 4 of the Ombudsman's report - "The documentary evidence" – refers to various statements made about occupational pension schemes during Parliamentary debates, and by Government bodies in leaflets and press releases etc. These are used as evidence to support the assertion that the Government did not provide full and accurate information. The Government does not accept this. The Government believes that the purpose of those statements needs to be set in a wider context, including the other information that would have been available to individuals. **Comment: This is just vague excuses, since it was Government itself which created the wider context. It took it upon itself to issue these leaflets and not one of them mentioned the risk of wind up or the effect of the priority order, especially for those with long service. If some had mentioned wind-up**

and some not, there may be a justification for this argument, but none of them did.

Leaflets

19. Departmental leaflets are designed to offer the reader basic information about a particular subject (be it occupational pensions or a social security benefit). As was said in the consultation document "Regulation, advice and information: the Government's proposals"

"The Government already produces a number of basic information leaflets on pensions. The aim of these is to provide straightforward explanations to enable people to understand the main pensions options and the differences between them. The FSA also produces a number of consumer guides....Such information is not, however, intended to be sufficient in itself to enable someone to decide about their pension needs, nor to choose between different schemes." **Comment: Members did read other information, such as from their employer, but would believe the Government's leaflets and use them for reassurance or confirmation of what the employers material said. That is why it was so important that the official material was correct and complete and since other material that members read would not mention the risks to non-pensioner members, it was even more important for Government to do so. Especially, of course, after the warnings from the Actuarial profession in 1999 and 2000.**

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Given that the information is aimed at the general public, leaflets normally concentrate on what might be called "mainstream" circumstances. In relation to occupational pensions, this means that they offer broad explanations that apply to the majority of members of pension schemes. **Comment: The leaflets mentioned other situations which would not be relevant to the majority of members. For example, they mentioned divorce and they did even mention fraud (which almost never happens) and employer insolvency, but still failed to mention the possibility of the scheme winding up and being unable to pay full pensions.**

20. They are explicitly not designed, however, to provide information tailored to the circumstances of particular individuals and people are expressly warned not to assume that the broad information given can be applied without question to their own situation. Their limited scope and nature is made clear by a general warning and the reader is told where more specific information can be obtained. **Comment: The fact that they are 'limited in scope' and cannot be relied on is not made clear and the other information the reader is referred to is mostly other leaflets in the DWP/DSS series that also contained the same misleading reassurances, or employer information which they had already read and which also talked about 'guaranteed' benefits etc.**

21. The principal Departmental leaflets considered by the Ombudsman are:

This list is not complete and, for example, the Ombudsman refers to the DSS leaflets issued in 1998, which it said at the time would provide 'impartial information' to explain benefits and risks of pensions from a source the public could 'trust'!

(a) the **PEC3 "The 1995 Pensions Act"** issued as a one-off print in January 1996;

(b) two editions of the **PM1 "A Guide to Your Pension Options**" (July 2001 and April 2003);

(c) three editions of the **PM3 "Occupational Pensions: Your Guide**" (May 2002; April 2003; April 2004);

(d) two editions of the **PM7 "Contracted-out Pensions: Your Guide"** (April 2003 and April 2004).

In addition, the Ombudsman considered three guides for pension scheme trustees issued by Opra: a general guide in 1997; and two specific guides to the MFR in 1999 and 2003.

22. As each leaflet served a different purpose they did not all contain the same information but such differences were **appropriate in the circumstances**. **Comment: This is a bland statement, and does not say how they were appropriate or in what circumstances. Since none of**

them mentioned wind-up, it is hard to see how the could all be considered appropriate. Of course, the 1997 OPRA guides was actually wrong, which can never be appropriate! The Government does not believe that the reader of any or all of these leaflets should have been left in any doubt that they would have needed more information to get a full picture of their own individual circumstances. **Comment: This 'belief' does not excuse what the Government has done. The Government used the same language in its original response to the Ombudsman, while she was conducting her inquiry and the fact is that, whether or not the Government believes it, people knew they should read the scheme information, and mostly they did so, but they were looking for confirmation of their position when reading official leaflets. But the leaflets did not alert them to the important questions they needed to ask –i.e. what would happen to their pension on wind-up, what would the effect of the priority order be, what level of funding was there for solvency? How could the reader know that the leaflet omitted the biggest risk their retirement income faced, if the leaflet never mentioned it in the first place?** Each of the leaflets made clear that they were designed to offer only generic, high level information. For example:

22.1 The PEC3 said that it was intended to be "***a brief summary of the changes***" in the 1995 Pensions Act. In a wide-ranging leaflet of 21 pages it covered the MFR in just four sentences;

22.2 The PM1 leaflet said that it was (and is) an "***introductory guide***" to pensions. Inevitably with such a large and complex subject as pensions, it devoted only a page and a half to occupational pensions;

22.3 The PM3 leaflet which was (and is) a guide to occupational pensions said explicitly that the guide "***looks at some questions you may need to think about and it tells you where you can find more information.***" **Comment: This leaflet does not mention the risk of windup, or tell people to ask about the effect of wind-up on their accrued contracted out rights and occupational pension.**

23. All of the leaflets contained explicit warnings that they were not complete explanations. Typically they said ***"This leaflet is for guidance only. It is not a complete statement of the law".*** **Comment: This is the same kind of disclaimer that was contained in the leaflets on SERPS, but which the DWP did not say was adequate to have excused leaving out the vital information about changes to the law or risks to surviving spouse's future pensions.** The Government considers that, taken together, such warnings should have been sufficient to alert the reader that they were not being given the **full detail** of the issues covered by the leaflet and that the leaflet was not comprehensive. **Comment: Why would these tiny disclaimers on the back of leaflets be sufficient to alert people that they were not being given even the basic outline of the most important risks they faced? These leaflets would not need to mention the full detail at all, all they would have been expected to do would be to mention, in broad terms, the possibility that people might not get the full accrued pension if their scheme wound up. The fact is, they did not mention this possibility, so the public was not able to ask the questions, or consider the implications.**

24. The Government does not consider it would have been appropriate to cover the MFR in the PM leaflet series as the Ombudsman suggests. As stated above, the PM1 leaflet was an introductory guide in which occupational pensions were covered in a page and a half. The series was designed as part of a wider set of communications to encourage those who had not made provision for their retirement to consider doing so and gave people a starting point for this, as is made clear. The PM1 said on the first page ***"If you want to enjoy your retirement, you need to plan how you are going to save for it."*** and also ***"These guides can give you helpful information, but only you can make decisions about your pension."*** It said further *on* ***"If you are not sure what to do for the best, you can get advice from a financial advisor."*** **Comment: The Government only says 'if you are not sure', it does not say that people must or should ask an adviser. Furthermore, after reading the leaflets, why would someone not be sure? Of course, the Government at the time also knew that most people would not ask a**

financial adviser about these pensions after the pensions mis-selling scandal and they would trust official information, rather than what an adviser said and the heading after this was ***"Where do I start?"***

25. Scheme members did indeed have access to other, more specific, information. As the actuarial profession's report in "Communication of MFR and Solvency" said **"*Members will also have access to the actuarial valuation, actuarial certificates and Annual Report as well as their Scheme Booklet.*"**

26. Even the 1997 Opra Guide, which was designed for a much more specialised audience of scheme trustees, did not attempt to cover the MFR comprehensively, and gave the reader the same warning***: "..this guide should not be taken as a definitive statement of the law. There is no substitute for obtaining professional advice...."*****Comment: But that does not excuse the fact that the booklet was wrong. This booklet was factually incorrect about the MFR. It told trustees that being fully funded on the MFR meant that there was enough money to pay full pensions on discontinuance (i.e. if the scheme wound up). That was not true and was not the design of the MFR, as the Parliamentary Ombudsman discovered that the MFR was only designed to give a 50/50 chance of full pensions. This mistake in the wording of the OPRA booklet was never brought to the attention of the member nominated trustees who had read it.**

Other official information

27. The Government has closely examined the other information to which the Ombudsman refers such as press releases and Ministerial statements in Parliament and believe these to be accurate, in their context. **Comment: Again, this is just an excuse, the context should not matter if the booklets were complete – as they were supposed to be under the DWP's own guidelines.**

28. The Ombudsman's report quotes extensively from a statement made by the then Secretary of State for Social Security in March 2000, for instance ***"The giving of wrong information by a government department is inexcusable. There is a clear responsibility to ensure that the information provided is accurate and complete."*** (paragraph 7.106) and ***"...we will also provide redress for those people who were wrongly informed and who, had they known the true position, might have made different arrangements...As a matter of principle, we believe that when someone loses out because they were given the wrong information by a government department, they are entitled to redress."*** (paragraph 7.107).

29. The report appears to be putting forward the proposition that these statements support the Ombudsman's approach in this case. However, the then Secretary of State for Social Security was speaking in relation to incorrect information given by the then Department of Social Security in relation to the **amount of SERPS a surviving spouse could inherit**. **Comment: This case is the same in respect of the SERPS benefit that was supposed to be replaced by the occupational pension scheme. These pension schemes also contained members' state pension rights too so this is very similar to the problem outlined in the inherited SERPS case, since members were not told that there was a risk that they may not get their SERPS-equivalent (the GMP) and, therefore, that their surviving spouse might not get full benefits.** This was a system where the Government was completely responsible for the structure, including the administration. Additionally, in this case **the information given was, at least in some cases, positively wrong.** **Comment: The information in the OPRA 1997 Guide was positively wrong, as was the information in the 1996 DSS guide.** Occupational pensions, by contrast, are administered, by the individual schemes' trustees. **Nothing the Government did created the losses incurred.** **Comment: This is not true. It was the rules of wind-up, the inadequacy of the MFR, the priority order and the requirement to buy bulk annuities which caused much of the losses suffered. The Government was responsible for these laws so it clearly did create the losses and the injustices for many people. Members of schemes which**

were 'fully funded' on the MFR, had no idea that this could mean they would lose their pensions if the scheme wound up. The law of wind-up, the priority order set by law, the requirement to buy annuities and the lack of chance for people to be given an opportunity to protect themselves and their dependents is due to Government actions and inaction. Solvent scheme wind-ups are a particularly relevant example here, since it was the MFR level that determined how much an employer was required to contribute and the MFR was controlled by Government. The Government stands by the statement made by the then Secretary of State in March 2000 in relation to schemes and services which it operates, but that situation simply does not apply here.

30. General press releases and Ministerial speeches in Parliament would not normally be suitable vehicles for explaining a complex issue such as the MFR. For instance, the findings in the report refers to a Commons debate on employment pension schemes in July 2001 as an example of *"conflicting messages"* which *"were being given about the security afforded by the MFR..."*. But the main focus of that debate was the position of trustees and trust law. It would have been inappropriate for the Minister to have spent the limited time available explaining the MFR in detail, rather than dealing with the main concerns of MPs attending the debate.

31. However, when appropriate the level of security offered by the MFR was explicitly referred to. For example:

Lord MacKay: 7 February 1995: ***"It is simply not possible either practically or economically to require ongoing pension schemes to fund at a level that will enable them to buy out all their liabilities with non-profit annuities. For many schemes the cost would be prohibitive..."***

Jeff Rooker: 3 April 2000: ***"The minimum funding requirement is not a guarantee of solvency"***

Comment: Neither of these statements is sufficient to justify the Government's failure to keep wind-up in mind when overseeing the

pension system and watch what was happening to annuity rates when setting the MFR itself, or when informing the public about their pension options. – especially in view of the stated 'policy intention' that on wind-up the scheme should be able to buy annuities for all pensioners and give a fair transfer value for all non-pensioner members' rights. Because annuity rates rose sharply, the cost of buying pensioner benefits rose far above the estimated MFR level, and this meant far less money left to secure transfer values for non-pensioners.

Scheme specific information and the role of trustees

32. It is clear that the only people who could give information about the specific circumstances of their scheme were the trustees and sponsoring employer of the scheme in question. **Comment: That would be fine, if the leaflets had alerted readers to the need to ask about funding and wind-up, but they did not.** As the leaflet PM1 said ***"If you are in any doubt, get as much information as you can (for example, by reading information from the scheme provider or by talking to a union representative or financial advisor) before you decide."*** **Comment: This does not say that people 'must' talk to an adviser, or 'should' talk to an adviser. The employer would not be impartial, so they would look to Government information for confirmation and endorsement of anything the employer said. Meanwhile, trade unions were misled too, by the OPRA booklets and official information. (The case of BUSM, which was one of the examples used by the Parliamentary Ombudsman is clearly described in her report).**

33. As set out in paragraphs 5 to 7 above, the role of the trustee was, and is, crucial in this respect. The 1997 Opra guide said:

'…members of the scheme have placed their trust in you to look after financial assets that will provide their benefits' and

'The duty to act prudently is particularly important when dealing with the scheme's investments. It means…considering the risks involved, obtaining and acting on appropriate professional advice'.

Comment: The trustees did look after the assets, took advice on the investments, but were powerless to prevent what happened on wind-up. It was Government rules which dictate wind-up. They become officially directed investments, no longer employer schemes run by trustees. Indeed, in 2000, the Pensions Minister, Jeff Rooker, admitted that it was up to the Governemnt to protect members, not trustees or employers. He said 'if we cannot do this, they have no-one else to look to'.

The 1999 Opra guide to the MFR said:

'You [the trustee] should always get appropriate legal advice about how the Pensions Act will affect your scheme. You will also need the advice of the scheme actuary. You should make sure you understand what your advisor's role is and that you understand the advice you are given'

Comment: If trustees were confused by the actuarial or legal advice – as almost all member-nominated trustees were bound to be, they turned to the official information for confirmation of the situation. They would assume that the material they received from OPRA and the Government would be accurate, why would they doubt that?

34. These were, and are, substantial responsibilities for trustees, many of whom act in a voluntary or unpaid capacity. It is nevertheless the case that all would have had professional advice available to them - indeed the law required and requires that to be the case. There is no question that those advisers – particularly the schemes' actuaries – would have been in any doubt about the actual level of security offered by the MFR from time to time. Additionally their advice would inevitably have made clear that the trustees could not have relied upon the scheme meeting the MFR to satisfy themselves as to whether the assets were sufficient in the case of their own particular scheme. They would have had to rely on other mechanisms and professional advice in making their judgments.

35. If and when the adequacy of the scheme's assets had been tested against the MFR, the actuarial certificate would have clearly stated that meeting the MFR did not equate to the scheme being able fully to buy out all

members' benefits - as was the case for all MFR valuations (see paragraph 14 above). That crucial point was reinforced in the Opra publication "A Guide to the Minimum Funding Requirement: a summary for pension scheme trustees" issued in May 1999 which said ***"This [meeting the MFR] will not necessarily ensure that all of a scheme's liabilities can be met fully if the scheme were to be wound up."***

Conclusion

36. It was the fundamental responsibility of trustees and employers to provide detailed information on their schemes to their scheme members. **These were not the Government's pension schemes**. **Comment: This remark seems to ignore the fact that these schemes actually contained members state pension rights. National Insurance contributions effectively went into them, so they are not just private schemes. Furthermore, the Government determined the rules of wind up and how the assets were divided, so again, it is not correct to claim these were entirely private schemes and nothing to do with the Government.** Their trustees were not the Government's trustees. **Comment: This statement ignores the fact that Government dictates what trustees have to do on wind-up, via the priority order, annuity purchase and recovery only of MFR level funding.** The Government did ensure - through Opra guides and actuarial certificates - that trustees were guided towards the information they needed. The other more general information which the Government provided in its leaflets was intended only to **provide basic information and its limitations were made clear. The Government does not accept the finding that this information was potentially misleading and, thus, maladministrative.** **Comment: It is vital that the Government is made to understand that this argument is just not rational. We know the Government does not accept the finding, but that does not make it wrong! The fact is that this information was not only 'potentially' misleading, it did actually mislead people. It was not complete since it failed to alert readers to any risk. If the Government refuses to realise how readers of official material actually think, then it will do this again and cuase more injustices in future. The inherited SERPS inquiry showed the DWP that it needed to be more careful about the material it**

issued to the public. In 2000, the Secretary of State accepted that previous leaflets had been incomplete and the small 'disclaimers' on the back did not excuse this. He also said he would ensure that the leaflets in future would be complete and accurate and comprehensive! Indeed, the DWP took legal advice on its responsibilities, as explained in the Parliamentary Ombudsman's report and this advice effectively said that if the Department gave wrong information, it would need to compensate.

Reviewing information in 2001

37. In September 2000 the Department published a report by the actuarial profession ("Review of the Minimum Funding Requirement"), part of which covered the issue of disclosure. After describing the protection offered by the MFR, the report said that the profession was concerned that this ***"..is not understood by members, trustees and employers, who believe that the benefits from a scheme which meets the MFR are fully secure*"**. It went on ***"It is therefore a key conclusion of the review that there should be a full and clear disclosure to members of the objectives and limitations of the MFR test and the consequences if their scheme should be wound up. We recognise that this ....could have major consequences as almost all employers and trustees have, until now, tended to stress the security aspects of occupational pension schemes in their communications with members."***

38. The Ombudsman believes that, on the basis of this report, the Government should have reviewed the official information which was then available. The Government does not believe that the report should have triggered such a review given that:

- none of the Departmental leaflets in circulation at that time was targeted at existing members of pension schemes. **Comment: This is nonsense! Members did read it, and nothing in the leaflet said it should not be read by members of schemes, or was only produced for people not belonging to a scheme! In any event, even non-members who might have been considering transferring into an employer scheme should have**

been alerted to the possible risk of wind-up. Members who were worried about the security of their pension, or the financial strength of their employer actually got this material from the DWP, read it and relied on it. It misled them into believing their accrued pension was not dependent on the employer at all, because it failed to alert them to the need to consider what would happen if the scheme wound up. As is made clear above, the PM leaflet series was designed to help people who had yet to begin saving for their retirement and the Opra Guide was designed to inform scheme trustees; **Comment: the OPRA guide in 1997 was wrong and trustees who had received it were never alerted to this or told to disregard the old leaflet and only read the new ones.**

- no one suggested that the Department was the appropriate body to inform scheme members about the position of the MFR in relation to individuals. **Comment: What a lame excuse. What was the Government's role then? If Government was putting out material for the public, to inform them of the benefits and risks of pensions – as it said it was doing – then it should have made sure it did actually mention the risks!,** The actuarial profession's report itself said ***"...Scheme Actuaries should encourage trustees to provide members with the information necessary to address any incorrect perceptions of the MFR."*** **Comment: Actuaries may have been asked to warn about the details of the MFR, but the MFR was only really inadequate on wind-up and the Government never mentioned the risk of wind-up in its material at all. On wind-up, the law takes over, requires expensive annuities to be bought and demands an unfair division of assets. This takes over from trustees and in fact, an independent trustee is appointed.** The discussions around this subject were concerned with how trustees (not the Government) could give their members proper information about the funding position of the scheme, without unduly alarming them; and

- the report did not suggest that Departmental leaflets had created or were adding to the confusion. **Comment: The Actuaries probably did not even know what the Government leaflets said, they were never likely to have even seen them! If the Department's leaflets were supposed to be accurate and comprehensive, why was the risk of wind-up not mentioned? Even if the actuaries' report focussed on trustees, that does not excuse the DSS from failing to recognise that it needed to reconsider the wording of its own leaflets. Officials should not need to be told to review their own material, they should be doing that themselves. Indeed, Alistair Darling assured Parliament that they would do so in future, after the taxpayer had to pay £13billion in compensation for the inherited SERPS fiasco.**

Conclusion

39. For these reasons the Government does not accept that the decision not to review published information in 2001 was maladministrative. **Comment: The Government may not want to accept it, but that does not change the fact that it was maladministrative and broke its own guidelines and contravened the commitment made by Alistair Darling to Parliament in 2000.**

The decision taken in 2002 to adjust the MFR

40. The Ombudsman's report refers to four Government decisions regarding the operation of the MFR, only two of which (the June 1998 decision and the March 2001 decision) were part of the complaint investigated:

40.1 In ***May 1998*** the actuarial profession recommended changes which brought the MFR down to its original level. These changes were agreed by the Government in ***June 1998***. This decision was part of the complaint and the Ombudsman found it was not made with maladministration;

40.2 In ***May 2000*** the actuarial profession recommended changes which would have increased the level of the MFR. These were not accepted by the Government in ***March 2001***. This decision was not part of

the complaint and the Ombudsman made no finding in relation to this decision;

40.3 In ***September 2001*** the actuarial profession recommended changes which would have lowered the MFR. These changes were accepted by the Government in ***March 2002***. This decision was part of the complaint and the Ombudsman found that the Department was maladministrative;

40.4 In ***February 2003*** the actuarial profession made a final recommendation to increase the level of the MFR. The Government did not accept these proposed changes. Again, this decision was not part of the complaint and the Ombudsman made no finding in relation to it.

Comment: Malcolm Wicks, Pensions Minister, misled the House of Commons when he gave a Parliamentary answer that said there had only been two recommendations by the actuarial profession to change the MFR and 'both' of them had been accepted. There had actually been 4, but only the two which recommended weakening were actually accepted. The behind the scenes reasoning for this, as discovered by the Parliamentary Ombudsman, was that officials at the DWP were concerned that changing the assumptions would lead to a change in the calculation of contracting out rebates, would increase the cost to the Treasury and that the Treasury had not agreed to this.

41. The Department has explained the rationale behind each of these four decisions to the Ombudsman. Each decision was taken based on a consistent judgement of two issues:

- whether the change would restore the MFR to its original level; and
- whether the change was sufficiently straightforward to allow it to be implemented before planned changes to the MFR were expected to be introduced.

42. In her report the Ombudsman finds that the ***1998 decision*** was not taken with maladministration, but finds that there was a lack of evidence to support the Government's decision to amend the Market Valuation Adjustment in ***March 2002***. The Government notes, however, the

Ombudsman's view that this change did not have any effect on the losses incurred by scheme members (paragraph 5.226 of the Ombudsman's report).

The March 2002 Decision

43. The Government believes that there is ample evidence to demonstrate why the decision was made to accept the actuarial profession's September 2001 recommendation. **Comment: The reality seems to be that the Government did not consider all relevant factors. It 'forgot' about the security of members' pensions on wind-up. It also does not seem to have considered the risk to members of solvent employer schemes, whereby the employer could simply decide to wind-up the scheme and only have to pay in enough to meet the MFR. This would leave members with only a fraction of their expected pensions. If MFR decisions were being taken, they should have considered all the relevant factors, yet it is clear that the problems of schemes winding-up were not considered when making the decision. This is maladministrative. Again, the Ombudsman has pointed this out, but Government has ignored it.** (The Government regrets in this context that the Ombudsman has declined to show the Government the actuarial advice that she obtained, and which is referred to in her report, which might have enabled any remaining doubts or misunderstandings to be resolved.) **Comment: The Ombudsman has said she would consider releasing this advice, but that it did not materially affect her findings and recommendations anyway, so it is rather a red herring here.**

44. The decision making process was consistent with how previous decisions had been made:

44.1 There was a clear recommendation from the actuarial profession, which had been developed by a committee containing leading technical experts from most of the major firms of actuaries.

44.2 Following receipt of this recommendation the Government Actuary's Department (GAD) was asked to consider it and to give an opinion on the recommendation. They responded by endorsing the profession's view without qualification.

44.3 The Department then considered whether there were any overriding policy reasons why it should not accept the actuarial profession's recommendation. **Comment: The security of members' pensions on wind-up should have been an overriding policy consideration, but was not even considered.** In particular the Department had to consider whether the recommended change was sufficiently straightforward to allow for it to be implemented before the MFR was expected to be replaced.

44.4 The change to the MFR recommended by the profession in September 2001 could be implemented quickly and without undue costs to schemes. This was in contrast with the change recommended in May 2000 which the Department rejected (in March 2001). Following consultation with the industry it was found that the changes recommended in May 2000 would have been unjustifiably costly and time consuming for schemes to implement, given that the MFR was expected to be shortly replaced. **Comment: This is a convenient excuse but again merely highlights that the Government was more concerned about employer affordability and perhaps its own contracting out rebate costs, than about member security. The security provided for both members' occupational pensions and for their state pension rights (the Guaranteed Minimum Pension) were also at the mercy of the MFR on wind-up, yet these factors were not considered when making the decision to weaken the MFR. The Government, therefore, did not consider all relevant factors and ignored an important issue. This is maladministration.**

.45. A reference has been made in the report (paragraph 5.105) to the fact that the Department rejected the recommendations that would *"increase the degree of protection afforded to scheme members".* This is to misunderstand the impact of changes to the MFR calculation. **Comment: No, it is actually the Government which has misunderstood it seems. The impact of the MFR on solvent scheme wind-ups and on the potential security of both pensions and GMP on wind-up was not realised.**

46. Even if a change to the MFR did require employers to fund the scheme at a higher level, the effect of that change would not have produced any immediate improvement in the level of security. The point made by the Government Actuary to the Ombudsman, in relation to the May 2000 change, has a wider application. He said: ***"Changes to the MFR were intended to provide incentives to schemes to improve their funding levels, although these changes could not achieve this immediately. Thus if the profession's May 2000 recommendations had been implemented, this would simply have led to schemes, in the short run, showing a lower percentage of coverage against the MFR."*** **Comment: This argument is certainly not valid for solvent scheme wind-ups, which only had to pay in enough to meet the (now weakened) MFR test, which meant that members' pensions were less secure on wind-up. Furthermore, if the Government knew that members' pensions would not be secure, it should have told them, but the official material failed to warn of this risk.**

Conclusion

47. The Government received a recommendation from the UK actuarial profession (as part of its role in continually monitoring the actuarial basis for the MFR) which was backed by the GAD and acted upon it. The Government does not believe that this decision was made with maladministration. The Government Actuary, in commenting to the Ombudsman on this issue (as is recorded in her report), has said that he considers that the evidence base for this decision was ***"extremely strong and much stronger than for many (probably most) of the decisions that have to be taken by Government".*** The Government does not believe that this decision was made with maladministration. Indeed, the Government would have needed strong grounds to justify not acting on the recommendation. No such grounds were apparent at the time. **Comment: There were strong grounds for not acting on the recommendation because of the lack of security for members' pensions on wind-up – again especially in the case of solvent employers who decided to wind-up their schemes. But Government did not consider this.**

Link between official information and losses incurred

48. The Ombudsman's report acknowledges that the losses suffered by those who complained to her were caused by a number of factors.

49. As her report notes, the immediate problem was that schemes wound up at a time when the assets held were not sufficiently valuable to secure all the scheme's liabilities. One key contributory factor here was the sustained downturn in world stock markets in 2000/01 - potentially affecting the value of the scheme's assets - and the associated economic situation, which may have been a factor in some insolvencies, which would have triggered the winding up of the pension scheme. **Comment: The other crucial factors were soaring costs of bulk annuities, the priority order and solvent scheme wind-ups.**

50. There were also other, less immediate, factors. The investment strategy of an individual scheme would have determined how far the scheme was exposed to the risk of a stock market downturn. In addition, at wind-up, pensioner members generally have their pensions secured by buying an annuity from an insurance company. Because of unanticipated increases in longevity and falls in interest rates, these annuities turned out to cost substantially more than previously, leaving less to be shared between the non-pensioner members. **Comment: Government should have considered the effect of rising annuity rates on wind-up, Parliamentary questions alerted Ministers to the problems being experienced by members of schemes winding up and the actuarial profession warned the Government that annuity rates had risen in 2000, which meant non-pensioners would be getting far less than their expected pension, because pensioner members' benefits were costing far more than the MFR calculation allowed for.**

51. The report also points to the pivotal role of the employer - where the company was solvent – given that triggering the wind-up in this situation is normally a voluntary action by such an employer.

Comment: But the employer complied with the law. It is the laws of wind-up that caused the losses to be crystallised and members to lose their pensions, due to the requirement to buy annuities and the pernicious effect of the priority order.

Actions influenced by the official information

52. The Ombudsman's report nevertheless maintains that if members had had sufficient information they might have taken different actions to safeguard their pension income. The Government does not agree with the Ombudsman on the sufficiency of the official information on the MFR. **Comment: It is the Ombudsman's task to decide whether or not the information was sufficient and she concludes that it was not. The Ombudsman also referred to the lack of any mention of the risk of wind-up, not just the MFR. This attempt to justify its actions with hindsight is precisely why it is so important that the Government must be challenged. They do not seem to understand how the public think or what effect their material has. This means they could do the same again and just try to claim they did nothing wrong, in defiance of the evidence. Members were misled by the official information, that is a fact and members have testified to this and proved it.** Furthermore it does not believe that there is a link between that information and the actions taken nor that scheme members would have necessarily acted differently, had the official information been worded in another manner.

53. Crucially, a number of the schemes covered by the report would not have had an MFR valuation before they went into wind-up. In these cases, self-evidently, members, even if properly advised about the limitations of the MFR, **Comment: It is not just the limitations of the MFR that is important here, it is the fact that the Government failed to mention the risk of pension losses on scheme wind-up. Members should have at least been alerted to the possibility of not getting their full accrued pension on wind-up** could not have taken account of such a valuation. Other schemes, which had had a valuation, would have been found to have been underfunded against this test. Even if the members of these schemes had

believed that, if their scheme was funded up to the MFR, they were fully protected, they could not have believed this protection applied to their scheme if underfunded. Therefore, any decision they made to join or stay in that scheme in these circumstances could not have been influenced by a belief that their scheme, was in some way, 'safe'. **The Ombudsman's report deals with this too. As she rightly says, how could any member or trustee be expected to realise that being 90% funded on the MFR could mean that people may get only 10% of their pension. The normal expectation would be that 90% funded would deliver 90% of the pension! Again, if that was not true, people should have been alerted to this, but they were not.**

54. Where their scheme had been the subject of a MFR valuation and had been found to have complied with it, it is clearly more plausible that the scheme's members might have sought to act differently if they had had a fuller explanation of what safeguards this did, and did not, provide. **Comment: This is directly relevant to members of the ASW Sheerness scheme, which was 102% funded on the MFR. If members had known this was meaningless in terms of delivering their accrued pension, they would have acted differently. Members can testify to this, because they read Government literature which failed to warn of the risks and knew the company was in trouble, so would have taken steps to protect themselves.** Even in those circumstances, however, and leaving aside the issue of the responsibility for any such lack of a fuller explanation, it is the Government's view **Comment: This may be the Government's 'view' but it is wrong. The fact is that people could have protected themselves.** that any action that could have been taken by members, either individually or collectively, would have been unlikely to have protected a greater part of their accrued rights, much less protected all of them. **Comment: Members who could have retired at age 60 but agreed to stay on because the employer asked them to, could certainly have protected their pensions simply by retiring when they could. The fact that they stayed on left them as 'non-pensioners' which resulted in them losing their entire pension, whereas they would have received their full pension if they had retired and been**

top of the priority order. Other members would have saved in a different form – perhaps ISA's – or taken more life insurance, because they would have wanted to ensure that their spouses would be looked after in retirement if they died. Indeed many possible actions would have exposed them to potentially greater risks.**Comment: This is not relevant, since the point is that they were denied the choice – if they chose to transfer out, that would be their decision.**

55. For example, taking some of the possibilities raised in the Ombudsman's report, it would have been very difficult to persuade an employer to inject more money into a scheme when that company was itself in serious financial difficulties. **Comment: Again, they were denied the chance to try and get more money and this argument does not apply to solvent employer wind-ups.** In addition it would have been surprising if the employer in such circumstances would have been able to find another company willing to take it over and fund the pension deficit.

56. Where individuals wanted to transfer their money out of their occupational pension scheme and to remain working for the sponsoring employer, their only realistic option would have been to have transferred their share of the fund (which might have been reduced by the scheme) into a personal pension. This would, however, have left them still exposed to the risk of stock market movements and the general economic situation, as well as having to pay management costs and is likely to have deprived them of the employers' contribution. **Comment: This argument is not convincing and does not apply for people who had 20, 30, or 40 years' service. They should still have been given the option to choose what to do, but they were denied that choice. That is a fundamental part of the injustice. How much they would have lost or gained from such a transfer would be** dependent on the company from which they chose to buy their personal pension and would not have been known until they reached retirement age.

Comment: This can be compared with the Government's response in the inherited SERPS situation, where the Government accepted that it was impossible to know what would have happened in each individual's circumstances, because they did not know the true situation they might face. That is also why the Parliamentary Ombudsman recommended full

compensation for all, because we cannot know or prove what would have happened in most cases, since people never had the opportunity to o anything.

Conclusion

57. For the reasons set out earlier in this response, the Government does not believe that the information issued by the Government can be regarded as having caused the losses described in the report.

- It was the fundamental responsibility of trustees and employers to provide detailed information on their schemes to their scheme members. **Comment: They did provide such information, but members were sceptical of trusting their employer or scheme material, so they tried to confirm it by reading the official information. The official information appeared to endorse scheme material which talked of 'guaranteed' benefits, legal safeguards etc.**
- The Government does not believe that the information it issued was inaccurate or misleading in its context on the level of security scheme members could expect, if their scheme was funded to the MFR. **Comment: The official material did not actually mention the MFR at all and it did not tell members they needed to ask about the funding level of their scheme. Parliamentary statements about the MFR were also misleading.**

Given the context and the intended audience, the information was complete. **Comment: This is just nonsense. The material was not even fit as a general guide and was certainly not complete. Even the 'intended audience' – which the DWP claims was people who did not already belong to a pension scheme – should have been warned that their pension may not be delivered from a final salary scheme if the scheme wound up. Someone considering joining an employer who was financially weak should have been warned that they may not get any pension if the employer subsequently failed. Furthermore, the leaflets do not mention what audience they are for and Parliament was told that they were being produced to educate the public and**

give them information about pensions they could trust. The DWP also promised that the information would be accurate, complete and comprehensive.

The leaflets were clearly limited in nature and contained clear warnings. **Comment: The warnings were not clear** Any reader would have been left in no doubt that they needed more information to get a full picture. **Comment: This is beside the point. The readers would not expect to have the 'full picture', but they were not warned about the huge risk they faced. Again, this is why it is so important that this response is challenged, because if the DWP really mean this and believe it, then we must prevent them doing it again. The readers are members of the public, they are not highly education public servants who know how to be circumspect about what they read. The readers are citizens who trust their Government and believe what official material says. If we do not ensure that the public can indeed trust official information, then we will undermine the role of Government itself.**

- As each leaflet served a different purpose they did not all contain the same information but such differences were appropriate in the circumstances and context of each leaflet. **Comment: This has not been explained how the leaflets could have been appropriate without mentioning the risk of not getting full pensions on wind-up. It ignores the fact that the leaflets were incomplete and did mislead the readers. They did not alert anyone to wind-up risk and they should have done.**
- The Government does not believe that the report of the actuarial profession "Review of the Minimum Funding Requirement" should have triggered a review of Departmental literature - the report was looking at how scheme trustees can communicate with their members.**Comment: This does not excuse the fact that officials failed to realise the implication of the actuaries' report for their own material. They should have thought about this themselves – especially after Alistair Darling's statements in 2000 and the legal advice obtained by the DWP, which said that its material must be complete, otherwise they would have to compensate.**

- The Department had more than sufficient information on which to make its decision on the MFR in March 2002. **Comment: The Government did not consider all the relevant factors when making its decision. It did not consider the security of members' pensions on wind-up, even though schemes had already failed and members had already started suffering large losses.**
- The causal link between the alleged maladministration and individual losses has not been made:
  - many schemes were not funded to the MFR, therefore the protection it may or may not have offered scheme members could not have been taken into account by them when reaching their decisions; **The Parliamentary Ombudsman has already dismissed these arguments. If a scheme was 90% funded on the MFR, that would not alert anyone to know that that could mean members getting just 10% or even 0% of their pension.**
  - any action members could have taken would not have protected a greater part of their pensions. **Comment: This is not true. Some could have retired, some could have transferred out, or not transferred in, taken out life assurance etc.**

Section 2: The Government Response to the Ombudsman's Recommendations

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58. The Ombudsman's report does not say that the Government alone caused the pension losses **Comment: What the report does say is that maladministration was not totally responsible for the financial losses, but it was responsible for the other injustices identified. Also, the report mentions the fact that the other causes of the financial losses were also almost all Government's responsibility. So although her remit only allows her to look at maladministration, she considers that the framework of the pension system, the laws and changes to the laws**

were also responsible for the financial losses. and does not, therefore, make recommendations based on the normal principle of putting people back into the position they would have been in had the alleged maladministration not taken place. Instead it recommends that the Government considers whether it should replace all the benefits lost by members of underfunded schemes which went into wind up between (a) 6 April 1997 and 31 March 2004; and (b) 1 April 2004 and 6 April 2005, acknowledging as it does that this raises significant public policy questions.

59. As the Ombudsman recommended, the Government did consider the report's proposals but rejected them because:

59.1 as explained in Section 1 it does not accept the findings of the report that the Department's official information was misleading, or that this information led to the **losses** suffered by those covered by the report; **Comment: The Government is only talking here about the financial losses, but is totally ignoring the other injustices highlighted in the Ombudsman's report. The sense of outrage, denial of informed choice, damage to health and so on are all directly Government's responsibility since, if people had been properly warned, rather than being lulled into a false sense of security, the losses would not have come as such a dreadful bolt from the blue.**

59.2 it noted that the recommendations went well beyond the accepted principle of putting people back into the position they would have been in, had the alleged maladministration not taken place, and considered acceptance would create a significant precedent across Government;

59.3 the Government believes it is not right to **use taxpayers' money to compensate people for losses** **Comment: The Ombudsman does not say that taxpayers' money has to be used, she merely says the Governemnt must organise the compensation. It could come from unclaimed assets, or any other sources, members SERPS rights**

could be taken back into the National Insurance scheme in full, or other compensation could be arranged, but it is up to the Government to organise it. In some cases, the Government itself may wish to challenge employers or trustees who it thinks acted inappropriately, but members cannot do this themselves which reflect the risks inherent in most, if not all, financial and investment decisions, unless that loss is caused by its wrongful actions. **Comment: Putting money into a final salary scheme was never presented to any member as an 'investment' decision, since they were led to believe that, unlike personal or money purchase pensions, these pensions did not depend on investment returns. These pensions were said to be safe, guaranteed and protected and also to be independent of the employer and funded according to officially approved standards designed to deliver accrued pensions in full. The official leaflets drew a distinction between final salary schemes and money purchase schemes, suggesting final salary schemes allowed easier planning for retirement because the amount of pension would be more certain.** It did not appear to be in the wider public interest to make an exception in this case;

59.4 the cost would be significant: at some £15 billion in cash terms over 60 years. **Comment: Using 'cash terms' is totally spurious and not statistically valid. Government spending is not calculated on cash terms, it is expressed in today's money. The net present value figure of £2.9bn-£3.7bn is the relevant one, with ongoing costs of around £100m a year in real terms. While** at the beginning of the period, the amounts would be lower, they would rise over time, reaching some £400 million a year by around 2030.

60. The Government was also asked to consider making consolatory payments to members of schemes that wound up underfunded between 6 April 1997 and 31 March 2004. This was considered and also rejected for the reasons given in the previous Section.

61. The Government was additionally asked to consider apologising to all scheme trustees. The Government considered this and rejected it, as it does **not believe** that trustees were in any way misled by official information. **Comment: Whether the Government 'believes' it or not, the trustees were misled by official information and the OPRA guide. Trustees of schemes can come and testify to this effect. The Government claims are simply not true. However many times you say black is white, it is stil black.** The Opra Guides made trustees' responsibilities clear and they always had access to professional advice.

62. Finally, the Government has accepted the recommendation of the Ombudsman to review the time it takes to wind up a salary-related pension scheme. It is also concerned about the time this takes and has begun work on this issue, although it notes that many of the reasons for delays are not within the influence of the Government. The Government will report further on the progress of this work in due course. **Comment: In fact, Stephen Timms, who was pensions minister in 1999, said that the Government would spped up scheme wind-ups. That was 7 years ago, wind-ups are still taking many years and in 2006 it seems rather rich for Government to agree that this needs to be done now, when it said the same in 1999!**

Section 3: Conclusion

63. The Ombudsman has investigated the complaints put to her in line with the Parliamentary Commissioner Act and has reached a view that an injustice arose from what she considered to be maladministration. She has quite properly reported her findings to Parliament. In the same way, the Government has reported to Parliament why it cannot accept them. It has been suggested that the Government's course of action might be to have the Ombudsman's opinion judicially reviewed, but the Government considers that the proper approach in such a situation is to provide its response to Parliament.

64. While the Government has rejected reports in the past (for instance, in relation to the Barlow Clowes investigation in 1989) no Government does so

lightly. Nor do Governments reject recommendations made by the Ombudsman without serious and very careful consideration. Despite hundreds of complaints being investigated by the Ombudsman each year, this is the first time that the Department for Work and Pensions (and its predecessors) has been unable to agree such findings and recommendations since the role of the Ombudsman was created in 1967. It is right for the Government to report this to Parliament in the way it is doing.

65. Where employers become insolvent the Government has introduced two major measures: the Pension Protection Fund and the Financial Assistance Scheme.

The Pension Protection Fund

66. The Pension Protection Fund will provide compensation for the members of most salary-related occupational pension schemes in the event of the insolvency of their sponsoring employer on or after 6 April 2005. Details of the operation of the Fund, including the levels of compensation and eligibility conditions can be found at http://www.pensionprotectionfund.org.uk/

The Financial Assistance Scheme

67. For those affected by the winding-up of their scheme following employer insolvency prior to 6 April 2005 the Government had already set up – before the Ombudsman's enquiry began - the Financial Assistance Scheme to provide a limited level of assistance to those within three years of their scheme pension age at 14th May 2004. The Government initially made available £400 million to support payments under the scheme over 20 years.
Comment: This is just 'assistance' not compensation and the £400m payments are subject to tax and recipients will lose means tested benefits, so the next spending on this is far lower than the headline figure.

68. The Government had intended to review the scheme as part of its 2007 Spending Review. In the light of the Ombudsman's report the review was expedited. In the White Paper, *"Security in retirement towards a new pension*

system" (Cm 6841), published on 25th May, the Government announced that the scheme would be extended.

69. Eligibility has now been extended to people within fifteen years of their scheme pension age. This involves tapers from 80 per cent of **expected pension** **Comment: This is an outrageous statement and is absolutely untrue. The FAS pays nothing like 80% of expected pension. The 'expected pension' includes index-linking, is not capped at £12,000, includes a tax-free lump sum and is paid from scheme pension age, whereas the FAS benefit is paid only from age 65 (many members lose an entire 5 years' worth of expected pension), is not index linked (which means after about 20 years the value is halved). This claim is misleading and factually incorrect and the Government should be asked to correct this immediately** for those within 7 years of their scheme pension age, 65 per cent if between 7 and 11 years, and 50 per cent for those between 12 and 15 years. This should ensure that around 40,000 people are helped. The total cash cost of assistance is expected to be around £2.3 billion over the lifetime of the scheme. **Comment: Again, cash costs are not appropriate and these benefits will be taxed and the costs offset by reductions on means tested payouts.**

2. Details of the operation of the scheme, including the levels of assistance and eligibility conditions, can be found at: http://www.dwp.gov.uk/lifeevent/penret/penreform/fas. Regulations with further details of the proposed extension will be published shortly.

Annex

Introduction

1. This Annex provides an explanation of the methodology and assumptions underlying the Government's estimate of the cost to Government of implementing the Ombudsman's proposals.
2. The Ombudsman asks the Government to consider the replacement of the entirety of the pension which affected individuals would have received had

their pension scheme not wound up or started to wind up with insufficient funds to meet all of its liabilities (core benefits) and associated benefits, such as life cover, survivor benefits and ill-health benefits (non-core benefits). The recommendations cover schemes which started to wind up between 1 April 1997 and 5 April 2005. This includes pension schemes with solvent sponsoring employers which are not covered by either the Financial Assistance Scheme or the Pension Protection Fund.

3. The Government estimates that implementing the Ombudsman's proposals would cost between £13 billion and £17 billion over 60 years in cash terms. Annual costs would vary over time, peaking at some £400 million around the year 2030.
4. The following assumptions were used to estimate the cost of the Ombudsman's proposals:
   - 125,000 eligible pensioner and non-pensioner members;
   - an average funding level of schemes in respect of non-pensioner members of 30-35%;
   - an average accrued pension for non-pensioner members of £3,300 per year;
   - longevity estimates from standard tables from the UK actuarial profession's Continuous Mortality Investigation, based on the longevity experienced by pensioners whose pensions are secured with insurance companies.

   The estimates are based on the expected cost over 60 years as the proposals cover all members who have suffered losses to their pension (some of whom may have been young when their scheme started to wind up) as well as their survivors. Costs would run further into the future but would be low after 60 years. Further detail on these assumptions is set out below.

Costing Methodology

5. Estimates of the cost to Government of implementing the recommendations in the Ombudsman's report are based on the model and data previously used to estimate the costs of the Financial Assistance Scheme (FAS).

6. In order to determine the likely cost of the FAS, data were collected on the numbers and characteristics of 380 pension schemes and specific data were collected on some 1,300 members of a smaller number of schemes thought to be reasonably representative of the total number. To estimate the cost of implementing the Ombudsman's proposals, these data, together with scaling parameters, have then been fed into an actuarial model to generate detailed time profiles of costs. To profile expected payments, the model makes a prudent assumption about scheme members' life expectancy, and also allows for specific features of the design of their pension scheme (for example, indexation after retirement, revaluation before retirement and normal retirement age).
7. The actuarial model uses data on members to calculate the amount of pension that would be paid in each year to each individual in the sample. The key pieces of information used to calculate these costs are: age, retirement age, accrued pension, percentage of pension lost and the likely longevity of eligible members and any survivors. The results, in terms of likely cash flow in each year, are scaled up to the level of the total assumed numbers of affected scheme members.
8. For example, if an individual is 55 years old and is a member of a scheme with a normal retirement age of 65, the model will revalue the individual's pension for 10 years, and start payments in year 11 when the individual has retired. The model will then apply the longevity assumptions and any assumed survivors' benefit to calculate the number of years in which payments need to be made. This process is repeated for each of the members in the sample and is subsequently scaled up to the population level.
9. This process leads to a complex but robust model, based on actual data, rather than a number of generalisations and broad assumptions. It does, however, mean that any simplifications of the model may be misleading, if the sophistication of the model is not taken into account.
10. A number of complex assumptions form the basis of the calculations. All of the key assumptions used in the calculation are data-based, as follows:
    - ***Number of eligible members*:** 125,000 pensioner and non-pensioner members.

- ➢ The great bulk of the members eligible for the proposed arrangement would be non-pensioners. The 380 schemes on which data were collected have around 70,000 non-pensioner members in total. In addition, DWP estimate that a few hundred more schemes, including a further 50,000 or so non-pensioner members, could have suffered losses. This estimate is based on DWP's data collection exercise and data from the Pension Schemes Registry, maintained by The Pensions Regulator (formerly Opra). DWP estimate that only around 5,000 pensioners would be eligible for payment as, because they are higher up the priority order, their pensions are already more highly protected than non-pensioner members and thus they are less likely to experience significant losses in their benefits.

- ***The assumed funding level of eligible schemes.*** The average funding level from the schemes' assets for a non-pensioner member is assumed to be around 30-35% of the cost of securing pension benefits.
  - ➢ This estimate is based on the average funding level of the schemes in the data collection exercise outlined in paragraph 6. For each scenario modelled, 30% is used to provide a lower estimate and 35% is used to provide an upper estimate.
- ***The average accrued pension*** of all non-pensioner members in eligible schemes is assumed to be around £3,300 per year.
  - ➢ This estimate is based on the average accrued pension of the 1,300 members in the data collection exercise. The accrued pensions are varied by 15% to provide upper and lower estimates for each scenario modelled.
- ***The longevity expectation*** of eligible members and their survivors which determine the length of time payments need to be made. The longevity estimates are taken from standard tables from the UK actuarial profession's Continuous Mortality Investigation. These are based on the longevity experienced by pensioners whose pensions are secured with insurance companies, and include allowance for future

improvements in longevity. They are commonly used for estimating the longevity of members of pension schemes.

- ***Ages of eligible members***. The age of eligible members would affect the number of years in which they would be entitled to revaluation and indexation respectively, the year in which they retire and the number of years that they would receive pension payments. The values are based on the actual ages of the 1,300 members from our data collection exercise.

Ombudsman's Proposals

11. The Ombudsman suggested that the Government should consider the replacement of both core and non-core benefits. For the purposes of these estimates core benefits are assumed to mean the monthly payments individuals would have received from their pension scheme on retirement if they had become deferred members of an on-going scheme at the point of wind up.
12. The assumptions made in relation to the most common non-core benefits which have been taken into account in the costings are as follows:
    a. Lump sums – The costing methodology is based on schemes' total accrued liabilities and therefore includes a proportion of the pension that individuals could take as a lump sum. The expenditure profile has been adjusted to take into account that providing lump sums
    b. Survivors – It is common for pension schemes to provide survivors rights at 50% of the rate of the original member's pension. However, some schemes provide more generous survivors' rights. The costings therefore looked at a range of values of survivors' rights in order to check the sensitivity of the costs to different levels of this benefit.
    c. Early retirement on ill health grounds – This would allow members to take their pension before normal pension age, normally not at a reduced rate (as would be the case for voluntary early retirement), and sometimes at an enhanced rate, to reflect the loss of service due to ill-health. Due to the complexity of this benefit it has not been included in estimates. Therefore, if the arrangement were to pay

pensions to people in ill health at below normal pension age, there would be an increase in cost above the current estimates.

d. Revaluation in deferment – The modelling assumes broadly scheme-specific rules up to the date of the start of winding up for each scheme and a standard rate after the start of winding up, in line with the Financial Assistance Scheme calculation. Applying scheme specific revaluation after the start of the winding up in the calculation of the benefits that members have lost would generally increase costs, but the overall effect would be small and, for simplicity, this adjustment has not been made in the central estimates of the cost of implementing the Ombudsman's proposals. However, costs have been modelled under a range of rates of revaluation, in order to establish how this might affect the overall costs.

e. Indexation after retirement – The modelling assumed indexation at a rate of 2.5 per cent, to reflect the fact that statutory Limited Price Indexation (LPI) requires pensions in payment to be increased in line with inflation capped at 2.5 per cent for rights accrued from 2005 onwards. No account has been taken of the way rates of indexation vary among schemes or of the more generous requirements that existed in the past.

Solvent Employers

13. There is very limited data on the numbers and circumstances of schemes with solvent employers which have wound up under-funded. Therefore it is not possible to estimate the costs of including these schemes with any certainty. The issue of schemes with solvent employers is complex, as many members of such schemes will have suffered small losses, if any loss at all (for example, where wind up is due to a merger of schemes and members are transferred to a different scheme providing the same benefits). Indicative estimates are that allowing for schemes with solvent employers could increase the costs by up to 25 per cent.

14. However, given the high level of uncertainties already inherent in the assumptions underlying the base costings, and the different circumstances of schemes winding up with solvent employers (e.g. possibly higher

funding levels), simply enhancing the base costing by 25 per cent would lead to an estimate with a very high degree of variability. The costs of covering schemes with solvent employers have therefore not been included in these estimates. These costings are thus likely to be an underestimate of the true cost.

Analytical Concerns

15. Given the limited information available on pension scheme members, their accrued pension entitlement and the level of losses they have incurred, the estimates are based on the assumptions outlined in paragraph 10 above. It would not be possible to provide a more reliable estimate until a significant number of schemes have completed winding up and have calculated their final assets and liabilities.
16. The range of estimates for the costs of restoring the full pensions of all members affected can be very large. Restoring each member's rights to 100 per cent would mean that the rules of each scheme which has begun winding up between 1997 and 2004 would have to be replicated in order that all members received exactly what they would have received from their scheme, had the scheme remained in place and the non-pensioner members become deferred members of the scheme. This would lead to an extremely complex arrangement where, for example, indexation and revaluation requirements would differ for members depending on the rules of their original scheme, and possibly differ over time for the same member, if their scheme had changed its rules during the period the individual was a member.
17. These complexities have been approximated by using a range of modelling assumptions and testing the sensitivity of the costs to these assumptions. There is, however, a risk that the costs would change significantly, depending on any final definition of the details of the arrangement.

Scenario Analysis

18. In order to be more confident of the range of possible estimates of the costs of the arrangement, some scenario analysis has been carried out. This approach is based on varying the non-core benefit assumptions in

order to check the sensitivity of the outputs to the inputs. Thirteen scenarios were modelled as outlined below:

- **Pension Age (4 scenarios)** – the pension age used in the model was varied in order to determine the sensitivity to scheme-specific retirement ages. If implementation of the Ombudsman's recommendations required scheme-specific pension ages to be used, the average pension age is likely to be less than 65. The values modelled were scheme pension age, fixed at 65, fixed at 62, and fixed at 60.
- **Revaluation in deferment (3 scenarios)** – currently the assumed rate of revaluation of pensions in deferment is 2.5%. However this may be higher in some schemes and so the effective rate of revaluation may therefore be higher. The values modelled were 2.5 per cent, 3 per cent, 4 per cent.
- **Survivors' benefits (3 scenarios)** – some members will have more than 50% survivors' rights. The values modelled were 50 per cent, 55 per cent, and 60 per cent.

Costs and Numbers Helped

19. The table below shows the range of cash and net present value[2] costs of providing full compensation to all affected members. Paragraph 12(e) outlines why 2.5 per cent indexation is the most appropriate assumption. The range of costs is a result of the scenario analysis on pension age, revaluation in deferment and survivor's benefit.
20. DWP estimate that the arrangement would provide compensation to 125,000 pensioner and non-pensioner members.

£billion

	Cash Cost	Net Present Value
2.5% indexation	13-17	2.9-3.7

[2] Net Present Value is used to compare costs that occur in different time periods. It is a separate concept to inflation and is based on the principle of 'time preference', i.e. that people prefer to receive goods and services now rather than later. NPV Costs discount cash costs by 2.5% per year to convert cash costs into real costs (to take account of inflation) and, in addition, by 3.5% a year in years 0-29, and by 3% a year in years 30 onwards to convert real costs into NPV costs (to take into account time preference).

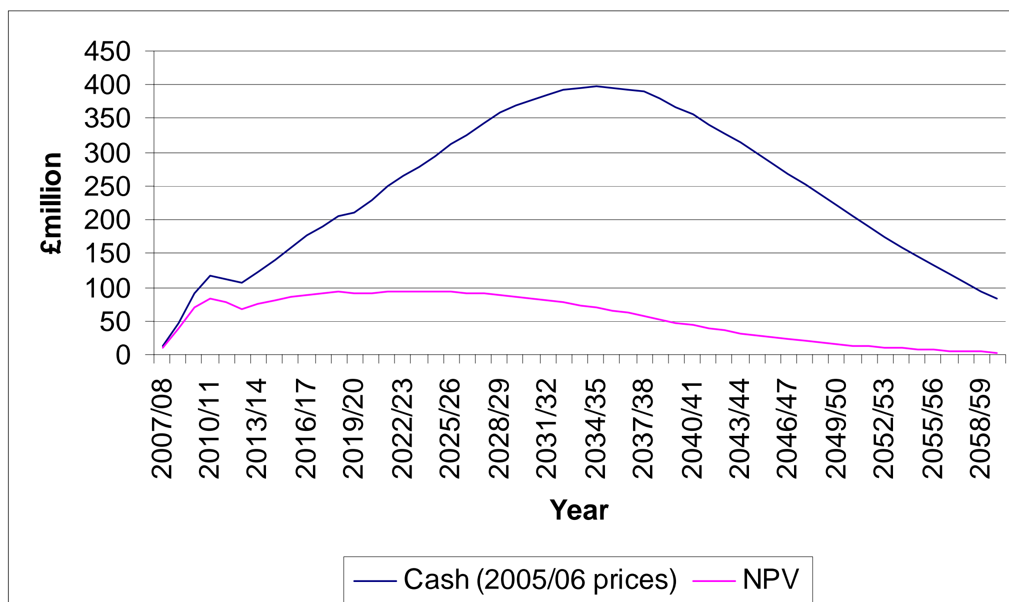
Comment: It is the net present value figure that is statistically relevant here. 'Cash cost' is a spurious notion that is not statistically valid and not normally used in costings of Government expenditure.

Notes:

- 2005/06 prices
- NPV Costs discount cash costs by 2.5% per year to convert cash costs into real costs and, in addition, by 3.5% a year in years 0-29, and by 3% a year in years 30 onwards to convert real costs into NPV costs.

21. The estimates are based on the expected cost over 60 years, the likely duration of benefits under the current FAS. However, given that an arrangement to meet the Ombudsman's requirements would cover all members of the affected schemes, the costs of the arrangements would run further into the future. The arrangement would need to continue paying out until the last survivor of a member of any scheme currently winding up had died (for example, if the member is 25 today, and lives until age 95, payment would be continuing in 70 years time, or later if the member left a survivor). **Comment: Younger members could be offered a transfer value into another pension scheme, as their entitlements will be very low, so that the lifetime of any compensation scheme would be shorter.** Costs after 60 years would be low especially in NPV terms, but would add to the total cost.

22. The graph below shows the typical long-term cost profile (the cost profiles for different scenarios may vary somewhat but this represents the typical shape):



23. The costs presented here are gross figures which do not take into account the increased tax revenue and reduced income-related benefit expenditure which would arise. It is difficult to estimate precisely, over such a long period, what the cost would be after taking these adjustments into account, as this will depend on the income distribution of people affected, the tax brackets they are in and their benefit entitlements.

Administration Costs

24. It is difficult to estimate the administration costs of an arrangement providing a full restoration of pensions to all those covered by the Ombudsman's report. As the arrangement would have to mirror the benefit structures for each qualifying pension scheme, it would be significantly more complex than either the Financial Assistance Scheme or the Pension Protection Fund.

25. Based on experience to date with known schemes, we estimate that one off set up costs might be around £10 million and during the first five years that it might take to assess scheme eligibility and calculate member benefits, the administration costs could be at least £14 million a year. The total costs over the first year or so reflecting the one off costs could therefore be around £20 million. Once the take on was complete and the main task became the payment of pensions, the costs would be expected to reduce.