Trusting in the pensions promise
Trusting in the pensions promise: government bodies and the security of final salary occupational pensions

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Session 2005-2006
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1. Introduction and background

**Introduction**

1.1. This report sets out the results of my investigation into complaints about the security of final salary occupational pension schemes and alleged delays in the winding-up of certain such schemes.

1.2. My report has eight chapters. This chapter explains my role and jurisdiction and the background to my investigation. The second chapter sets out in detail the nature of the complaints that I have investigated and the Government’s initial response to those complaints, before explaining the approach I have adopted to determine whether the complaints are justified.

1.3. The third chapter sets out the results of the further enquiries I made as part of my investigation to help me to better understand the context of the complaints. The fourth chapter sets out the evidence that my investigation has disclosed through consideration of departmental files, official publications and other documentary sources. The fifth chapter contains my findings and the sixth chapter contains the recommendations arising from those findings. The seventh chapter sets out my assessment of the Government’s response to my report – and the eighth is my conclusion.

1.4. There are also five annexes to this report – the first of which sets out elements of the relevant statutory, regulatory and administrative frameworks within which final salary occupational pension provision operates. The second annex sets out the technical scope of the actuarial advice I have received to help me to investigate whether the complaints made to me disclose maladministration causing injustice. The third annex deals with certain submissions made by the Government during the investigation to support its case.

1.5. The fourth annex sets out the Government’s formal response to my report and the fifth sets out the response made to it on behalf of complainants.

**My role and jurisdiction**

1.6. My role is determined by the Parliamentary Commissioner Act 1967 (the 1967 Act), as subsequently amended. As provided for in the 1967 Act, I investigate complaints referred to me by a Member of the House of Commons that an individual has suffered an unremedied injustice in consequence of maladministration by a body in my jurisdiction.

1.7. The actions or inaction of bodies in my jurisdiction that I may investigate do not include action taken in relation to their judicial or legislative functions but are limited to the exercise of administrative functions by such a body which are not of a prescribed nature.

1.8. Schedule 2 and Schedule 4 to the 1967 Act list the bodies within my jurisdiction. Schedule 3 prescribes the types of administrative actions that I may not investigate.

1.9. Section 5(2) of the 1967 Act provides that I may not conduct an investigation of a complaint where the person aggrieved has or had a remedy before either a court of law or a statutory tribunal, unless I am satisfied that, in the circumstances of the case, it would not be reasonable to expect that person to exercise such a remedy. Where such a remedy has already been exercised, I no longer have discretion to investigate such a complaint.

1.10. Section 7(2) of the 1967 Act requires that any investigation I undertake must be conducted in private. The same section also provides that, except for this requirement, the procedure for conducting an investigation shall be such as I consider appropriate in the circumstances of the case. It also provides that I may obtain
information from any source – whether from a body in my jurisdiction or not – that I consider appropriate, with the exception of Cabinet papers or material from bodies not in my jurisdiction which is covered by legal professional privilege.

1.11. Section 12(3) of the 1967 Act also provides that I may not question the merits of discretionary decisions taken by bodies in my jurisdiction where those decisions were taken without maladministration.

Pension provision in the UK

1.12. This investigation relates to certain aspects of pension provision. Annex A to this report sets out the context in which the subject matter of this investigation is placed and explains in more detail many of the more complex or technical aspects of this report.

1.13. There are five principal categories of pension provision in the UK:

(i) state retirement pensions – which have both a basic and additional component;

(ii) retirement annuity contracts – which have ceased to be entered into since July 1988;

(iii) personal pensions (from July 1988 to date) and stakeholder pensions (from April 2001 to date);

(iv) public sector occupational pension schemes, including those for current members (and veterans) of the armed forces; and

(v) private sector occupational pensions.

1.14. This report is concerned with pension provision obtained through membership of certain private sector final salary occupational pension schemes.

1.15. This is because the complaints that I have received relate to certain alleged actions (or inaction) by those responsible for the legislative framework governing private sector occupational schemes – and because the injustice claimed by those making these complaints stems from the failure by certain final salary schemes to pay the full pension rights and other benefits promised to their members.

1.16. The subject matter of this report primarily relates to the statutory arrangements for the funding of such schemes, to the process of winding-up those schemes where that happens, and to the actions of public bodies in relation to both.

1.17. The key aspects of the statutory arrangements for scheme funding that are relevant to this report relate, first, to the purpose, design and operation of the Minimum Funding Requirement (MFR), which prescribed the level of contributions that a scheme had to hold. Secondly, it is concerned with the way in which the law required that the assets of schemes should be realised and the liabilities of schemes should be discharged when they wind up.

1.18. However, this report also touches on the interaction – through the contracting-out process – between pension provision through final salary occupational pension schemes and state retirement pension provision.

1.19. This is because the injustice claimed by those who have complained to me does not relate only to the loss of the pension and other benefits derived from the contributions made by them and their employer to their scheme. It also relates to the loss of part or all of the ‘Guaranteed Minimum Pension’ (GMP) or equivalent, which was to be provided in respect of national insurance contributions made by both the employer and employee and paid to the scheme if the relevant employment was contracted out of the State additional pension scheme.
Government and occupational pensions

1.20. Occupational pension provision is currently a topic of considerable public interest. It is also an area in which complaints are often made.

1.21. However, as outlined above, I may only investigate certain complaints within the framework provided by the 1967 Act. I thus turn to consider which public bodies have a role to play in the subject matter of this report.

DWP/DSS

1.22. Responsibility in Government for occupational pensions policy and for the framework of law and regulation that relates to final salary schemes has, at all times relevant to the subject matter of this investigation, lain with the Department for Work and Pensions (DWP) or its predecessor, the Department of Social Security (DSS). Both published general information leaflets and other material related to occupational pensions.

1.23. DWP has developed internal guidance, which is supplemented by a departmental Public Information Strategy and by policy frameworks to support the strategy within each of DWP’s business units and executive agencies.

1.24. DWP and its predecessor have, since January 1997, published a guide, entitled Financial Redress for Maladministration, which sets out the approach it takes when considering remedies for justified complaints. This guide describes the special payments scheme operated by DWP and provides advice on the consideration of financial redress in respect of maladministration. It also provides examples of what, in DWP’s view, constitutes maladministration and sets a context in which to consider official error, the circumstances when financial redress should be considered, and the redress that DWP considers is appropriate for each type of case.

A revision of this guide in April 2003 contained new definitions of information and advice.

1.25. DWP has also defined the categories of information and advice that it might be asked to provide. Its internal guidance, agreed in March 2002, specifies that officials:

\...should ensure that customers are given:

- full and accurate information (that is, general factual data which is not customer specific);
- general advice (for example, the promotion of Government policy – work is the best form of welfare; people should save for their retirement) to enable them to make their own decisions;
- specific advice where it is appropriate to do so (for example, information tailored to a customer’s individual circumstances and requirements, which may identify a number of options but does not indicate the official’s view of the best course of action). The specific advice provided should be full and accurate to enable the customer to make his or her own decisions; and
- recommendations where specific business areas of the Department have specified that it is appropriate to do so (for example, a statement to a customer suggesting his or her best course of action). Under such specific circumstances, the member of staff may provide his or her view (as an official of the Department) of the best option for the customer. Care must be taken when providing specific advice or (where appropriate) a recommendation, to ensure that the customer’s personal circumstances are fully taken into account.

1.26. Since April 2000, the Social Security Advisory Committee, an advisory non-departmental public body appointed by the Secretary of State, has scrutinised a selection of
DWP’s information leaflets aimed at the public, with a view to ensuring their accuracy and completeness. The Committee’s remit, however, does not extend to information provided by DWP about occupational or personal pensions.

Her Majesty’s Revenue and Customs

1.27. The Inland Revenue was – and its successor, Her Majesty’s Revenue and Customs, is – responsible for the authorisation of pension schemes and for ensuring that they satisfy the conditions to make them eligible for tax relief and to be able to contract out of the state additional pension scheme.

1.28. The Savings, Pensions and Share Schemes section of what is now Her Majesty’s Revenue and Customs considers elections from employers who wish to contract out of the additional state pension and it issues relevant contracting-out and tax certificates if an election is approved. When a scheme ceases to contract out and begins wind-up, it will cancel the appropriate certificates on behalf of Her Majesty’s Revenue and Customs and notify the National Insurance Contributions Office (NICO), which triggers cessation action.

1.29. NICO’s National Insurance Services to Pensions Industry group (as it is now known) was formed in 1978 and its role is to ensure that the rights of people contracted-out of the additional state pension through an occupational or personal pension scheme are accurately recorded, maintained and secured. In order to do this, it liaises with other public bodies on contracted-out related issues, it approves a scheme’s arrangements, it manages individuals’ national insurance records, and it deals with Notices of Termination of contracted-out employment – and other correspondence and telephone enquiries on related matters.

The Financial Services Authority (FSA)

1.30. The FSA and its predecessor have been since 1988, among other matters, responsible for the regulation of the sale and marketing of personal pensions. The FSA is not in my jurisdiction for the purposes of this investigation (see paragraph 1.50 below).

The Occupational Pensions Regulatory Authority (OPRA)

1.31. From April 1997 for eight years, OPRA was responsible for the regulation of occupational pensions. It also had responsibility for collecting the levies from schemes to fund its activities and to finance a compensation scheme for situations where fraud or other unlawful activity had occurred. It was also responsible for the Pension Schemes Registry, which kept records related to occupational schemes. OPRA was replaced in April 2005 by a new Pensions Regulator, which, while being an entirely separate body, has residual responsibility for OPRA’s affairs. The Pensions Regulator is also responsible for the Pension Schemes Registry.

The Government Actuary

1.32. The Government Actuary and his Department (GAD) provide actuarial advice to a range of clients. These include managers of pension schemes throughout the public sector; trustees of funded pension schemes in both the public and private sectors; various Government departments and sponsoring employers; and the Treasury in relation to general pensions policy in situations where Government is either the employer or has a financial interest. GAD is not in my jurisdiction for the purposes of this investigation (see paragraph 1.51 below).

Background to the complaints

1.33. According to statistics produced by OPRA’s Pension Schemes Registry, in March 2004 there were 94,535 ‘live’ occupational schemes – of which 9,834 were private sector final salary
schemes. The latter figure reflected a sustained downward trend in the number of such schemes.

1.34. Earlier, in December 2002, the Government had recognised, in the Green Paper setting out its proposals for pension reform that were to become the Pensions Act 2004, that there were growing political, social and economic concerns about the effectiveness and sustainability of the system of pension provision in the UK.

1.35. In relation to the private sector, these concerns included the effects of increased longevity and other demographic trends, signs of a decline in work-based pension provision, the complexity of pension products, the cost of financial advice, the legacy of personal pensions mis-selling, and a trend towards earlier retirement.

1.36. The Green Paper also referred to the fact that ‘employee confidence has also suffered due to the action of a few companies, who have let their employees down when they have become insolvent with an under-funded pension scheme’.

1.37. The Government’s proposals to remedy this position included the replacement of OPRA by a new regulatory body and the establishment of a Pension Protection Fund (PPF) to protect members of private sector final salary schemes.

1.38. On 6 April 2005, the PPF became operational as a result of the commencement of the relevant provisions of the Pensions Act 2004. The PPF will pay compensation to members of eligible occupational pension schemes, when there is a qualifying insolvency event in relation to the employer which sponsors a scheme and where there are insufficient assets available to the scheme to provide to its members the level of compensation set out in the legislation governing the PPF.

1.39. The pension schemes whose members may be eligible for compensation from the PPF are limited to those which began winding-up on or after 6 April 2005 and the PPF does not extend to those schemes where a sponsoring employer remains solvent.

1.40. The Government also established a Financial Assistance Scheme (FAS) to provide ‘assistance’ to those whose schemes would not be covered by the PPF because their scheme had begun winding-up prior to 6 April 2005. Like the PPF, the FAS will not cover those who were members of a final salary occupational pension scheme where the sponsoring employer is not insolvent.

1.41. This fact – and early indications that ‘assistance’ from the FAS was to be limited in a number of significant ways and would not cover the whole of the losses that had been or would be incurred by scheme members – led to a campaign to persuade the Government to accept liability for (and to pay compensation to remedy) the whole of the losses incurred due to scheme failure, which it was alleged was caused by maladministration on the part of public bodies.

1.42. In addition, legal action in relation to the alleged incompatibility of the domestic legal regime for the protection of pension rights with European law was initiated by trades unions representing some of the affected workers. I understand that this legal action is continuing.

1.43. I now turn to summarise the complaints I received about these matters.

The complaints received

1.44. I have received more than 200 complaints referred to me by Members of Parliament of all political parties and from all parts of the UK – and I have also received more than 500 further direct representations about the same matters.
1.45. The complaints which formed the basis of this investigation had four elements:

(i) first, it was alleged that the legislative framework during the relevant period (that is, from commencement of the Pensions Act 1995 to commencement of the Pensions Act 2004) had afforded inadequate protection of the pension rights of members of final salary occupational pension schemes;

(ii) secondly, it was alleged that, on a number of occasions, Ministers and officials had ignored relevant evidence when taking policy and other decisions related to the protection of pension rights accrued in such schemes;

(iii) thirdly, it was alleged that the information and advice provided by a number of Government departments and other public bodies about the degree of protection that the law provided to accrued pension rights had been inaccurate to the extent that it had amounted to the misdirection of the members and trustees of such schemes; and

(iv) fourthly, it was alleged that public bodies were responsible for unreasonable delays in the process of winding-up schemes.

Assessing the complaints

1.46. There are four aspects of my jurisdiction that I have outlined above that were relevant to my consideration of the complaints I received from members and trustees of occupational pension schemes and to my decision to conduct an investigation into some of those complaints.

1.47. First, it is not for me to question the adequacy of legislation enacted by Parliament or of European law. While, in any investigation, I will have regard to the relevant legislative framework and – at its end – may draw Parliament’s attention to situations where I consider that the relevant legislation has had a direct bearing on the injustice claimed by complainants, I do not have the power to investigate complaints that legislation itself is inadequate, unfair or has caused injustice to an individual.

1.48. Thus I was not able to investigate the first element of the complaints I had received – namely, that the law related to occupational pension schemes was, in the relevant period, inadequate to protect the pension rights of members of schemes that wound-up with insufficient assets to cover the scheme’s liabilities.

1.49. Secondly, I am only able to investigate the administrative actions of bodies in my jurisdiction. The complaints I had received were primarily directed at DWP and its predecessor, DSS, at Her Majesty’s Treasury (the Treasury), at OPRA, and at NICO. Those are all bodies within my jurisdiction and I was able to investigate their relevant actions.

1.50. However, the complaints also related to the actions of the FSA, which is a body that is not in my jurisdiction, except to the extent that it acts or acted on behalf of a body in my jurisdiction. Having determined that the actions of the FSA about which complaints were made related to the FSA’s own functions, I was thus not able to consider complaints about those actions. In the rest of this report, therefore, the information and advice provided to pension scheme members by the FSA under section 206 of the Financial Services Act 1986 is referred to only to help place my investigation in context. The FSA has developed its own standard for the production of promotional material issued by firms that it regulates. This standard, to which the FSA subscribes for its own consumer publications, requires that such material should be ‘clear, fair and not misleading’.

1.51. Similarly, this report sometimes makes reference to GAD. GAD is only in my jurisdiction
in relation to complaints about its actions in providing advice to the prudential regulator of life insurance companies in the period prior to 26 April 2001 – and so reference to the actions or advice of GAD in relation to the subject matter of this report is also only made to place the events recounted in context.

1.52. In addition, the actions, advice or publications of the professional bodies of the actuarial profession, which, in England and Wales, is the Institute of Actuaries and, in Scotland, the Faculty of Actuaries – neither of which is in my jurisdiction – are referred to only insofar as they help to place the actions of the bodies under investigation in context.

1.53. Moreover, those who administer or advise pension schemes are not in my jurisdiction – nor do I have the power to investigate complaints about pension scheme trustees.

1.54. Thirdly, as mentioned above, trades unions representing some of the individuals who have lost part or all of their pension rights in consequence of the winding-up of their scheme have initiated legal action in the European courts. That action relates to obligations placed on member states of the European Union by Article 8 of the EC Insolvency Directive to protect the rights of members of occupational pension schemes.

1.55. I considered whether the existence of this litigation constituted the exercise of an alternative remedy which would preclude me from conducting an investigation. I established that this action related to a complaint that UK domestic law is or was incompatible with European law, which, as I have explained above, is not one that I could investigate. Therefore I concluded that this litigation, on different matters and with a different focus, did not preclude me from undertaking an investigation. Furthermore, at no time during my investigation did the Government suggest in their responses to my enquiries that the existence of this litigation had introduced any difficulties in relation to my jurisdiction.

1.56. Moreover, insofar as complainants might have another remedy in the courts for the other specific complaints they made to me, I did not consider it reasonable to expect individuals to resort to expensive and uncertain litigation before the courts and, in any case, I was advised that no such remedy for most of the specific administrative complaints existed.

1.57. Finally, as also explained above, I may not question the merits of discretionary decisions taken without maladministration. Therefore, insofar as the complaints related to policy decisions made by Government Ministers or officials, my investigation was limited to establishing whether such decisions were taken with maladministration.

**My decision to investigate**

1.58. I had been shown indications that maladministration might have caused injustice to those who had complained to me – and to those in a similar position as those complainants. I also believed that my ability to access evidence which was not available to complainants meant that an investigation by me would achieve a worthwhile outcome, whatever its result. I therefore decided to conduct an investigation.

1.59. My decision was announced on 16 November 2004 through a letter to all who were then Members of Parliament, which was also sent to all those people who had by then complained to me.

1.60. My investigation was limited to those matters and bodies over which I have jurisdiction and was undertaken using four individual scheme members who made complaints representative of all those I had received. In addition, while I
understood why individuals might direct their complaints at the Treasury, I investigated only those departments or other bodies which had policy responsibilities relevant to the subject matter of the complaints.

**Other observations**

1.61. Before turning to consider in detail the position of those who have complained to me, I wish to make three preliminary observations.

1.62. First, my jurisdiction covers the whole of the United Kingdom. One of the four representative complainants in this investigation lives in Northern Ireland, with the others living in the north-east of England, the East Midlands, and the south-west of England. The other complaints I have received on these matters have come from every part of the UK — and with some of those making complaints living overseas.

1.63. The statutory framework relevant to the matters I have investigated differed in detail — but largely not in substantive terms so far as the key focus of this report is concerned — between the different parts of the UK. For example, Northern Ireland had (and has) its own system of pension law — which, while its provisions were directly equivalent to those which existed in Britain, was established in the main by separate primary and secondary legislation. Similarly, in Scotland there were and are some relevant differences with the law as it stood in the rest of the UK — primarily in the fields of trust law, divorce and insolvency — as well as the existence of a distinct system of courts and other institutions.

1.64. Therefore, I have not concentrated in this report on spelling out in each case from which statute or from which piece of subordinate legislation any specific provision has been derived. I have also sought to use the broadest terms to describe legislative provisions, concepts, procedures and specific actions — which I acknowledge may sometimes differ in detail in the different parts of the UK.

1.65. Secondly, reference is sometimes made in this report to the revised legal framework created by the Pensions Act 2004, which received Royal Assent on 18 November 2004 — especially in relation to the pension protection and financial assistance measures it established. However, the primary focus of my investigation has been on the period between the first parliamentary discussion of the Bill which became the Pensions Act 1995 (that is, when citizens may first have become aware of the intent behind and content of those proposals) and the commencement of the 2004 Act’s principal and relevant provisions, which replaced the earlier regime.

1.66. Thus, the key period that is relevant to what follows is the approximately ten year period from 24 January 1995 to 6 April 2005.

1.67. Finally, the subject matter of this report is generally recognised as being complex and sometimes highly technical. To cover every aspect of the landscape of occupational pension provision and regulation over more than a decade — and all the issues related to that provision — would be a considerable challenge and one that would have made this report much longer, had I undertaken to do so.

1.68. I have also been deeply aware that the people most affected by the events covered by my investigation continue to encounter an uncertain financial future and that they have expressed a wish that I should do everything possible to present my report as soon as possible, while recognising that I must consider thoroughly the relevant issues. They also have sought clarity and an explanation of what has happened to them.
1.69. This report therefore is not an exhaustive study of all of the issues currently relevant to final salary pension schemes, nor does it set out every detail that I or my staff have considered and investigated. It is focused on the specific complaints that have been made to me in relation to the particular injustices claimed.

1.70. That said, I am satisfied that nothing of significance has been omitted from my report. I have also attempted to keep the language used as simple as possible and the degree of technical detail to the minimum necessary to ensure that my assessment is authoritative – yet still, I hope, clear.
Introduction
2.1. This chapter sets out in detail the complaints I have investigated – and the position of those who have complained to me – and also the Government’s initial response to those complaints.

2.2. It also explains the approach I have adopted to help me to decide whether maladministration has caused injustice to those who have complained to me – and to those in a similar position to those complainants.

The representative complainants
2.3. In line with my usual practice where I receive many complaints from people in similar situations who all claim to have suffered injustice due to the same administrative actions, I decided to conduct one investigation. On this occasion, I have used four complainants as representative of all those who had complained to me. I now turn to the position of those four complainants.

The representative complainants – Mr J
2.4. The first representative complainant is Mr J. He lives in Northern Ireland and is at the time of writing 62, having been born in June 1943. He worked for an agricultural company as a mechanical engineer from August 1974 to November 2002, being a member of its pension scheme and making additional voluntary contributions for the same period. He was originally compelled to join the scheme as a condition of employment and he has not worked since being made redundant.

2.5. He is married with three sons, the middle of whom also worked for the same firm. The company was placed in voluntary liquidation by its two principal shareholders, one of which was a major multinational company and the other the Government of another EU member state. Over 70% of those made redundant had given more than 25 years service to the company at the time of liquidation.

2.6. The scheme is still being wound up but the trustees estimate that Mr J might receive only 14.9% of his expected benefits when the scheme is finally wound up, as there is a shortfall of £21 million on the statutory basis. He has also been told that even this proportion is not ‘guaranteed’. In August 2000, Mr J had applied for early retirement (the scheme’s usual retirement age was 62) but his company did not respond to his application. This did not unduly worry him as he believed his pension to be both guaranteed and safe.

2.7. In April 2004, Mr J suffered a serious heart attack which required surgery and he is still being treated for heart failure, for which he continues to take medication on a daily basis. He told me that ‘it is certain that the stress and worry regarding all of these issues have caused this illness’.

2.8. Mr J showed me some of the material that had been issued to members by his scheme. The principal explanatory booklet for the scheme issued in 1998 had said that ‘the plan must have adequate resources which satisfy the minimum funding requirement of the [1995] Act, which is designed to make sure that the benefits are protected whatever happens to the company’ and also that ‘the plan is designed to provide you with a guaranteed pension related to your earnings – and therefore to your standard of living – close to retirement’. It had also used the term ‘guaranteed’ on other occasions.

2.9. He told me:

The initial relief which information about the FAS gave has now given way to despondency. I do not know if I will be covered by it... No-one from any of the government bodies ever warned me that there could be potential problems with my pension. All of the information coming over the
years from public bodies had convinced me that my pension was safe and that I could rely on it in retirement.

2.10. He continued:

*It is the government’s responsibility to restore my pension in full to that promised and I also feel that I am entitled to some compensation for all the stress and suffering which this pension problem has caused.*

The representative complainants – Mr G

2.11. The second representative complainant is Mr G. He is currently 54, having been born in September 1951. He is married with children and lives on the border between Warwickshire and Leicestershire.

2.12. He worked from August 1976 to June 2003 for the same distribution company, although over this time the company was subject to a number of mergers and takeovers. He began as an assistant depot manager, subsequently became a depot manager and then a contracts manager. From 1997 to 2003, he was the firm’s rates and contracts manager.

2.13. His employer decided to wind up the pension scheme in February 2002. It was 101% funded on the MFR basis at that time. He was subsequently advised that, as the scheme was not able to meet its liabilities in full, he would be likely to receive a pension that was only about 24% of his accrued rights and that this would reflect only approximately 75% of his Guaranteed Minimum Pension.

2.14. Mr G, being disillusioned with the actions of his employer and the effects that the wind-up of his scheme was likely to have on his pension entitlements, decided to look for new employment and he has, since June 2003, been a warehouse and distribution manager for another firm, based much further from his home.

2.15. Mr G told me that he had believed that his pension was guaranteed and provided copies of material, including of debates and press cuttings related to the passage of the 1995 Pensions Act, which he said had helped to give him this belief.

2.16. He said:

*No information warning members of the level of risk has ever been issued by DWP or other public bodies. Nor did the Government see fit to insist that scheme trustees were required to inform deferred members of their perilous situation. If I had had any inkling that my “Certificate of Entitlement to Benefits” was not worth the paper it was written on or that my “benefit” could be reduced in such a substantial fashion, then I would have taken a cash transfer when that certificate was issued in September 2000.*

2.17. He continued:

*No financial product would be sold bearing this level of risk without the level of risk being emblazoned on it. Why not here? I have worked for 27 years on the basis that I was entitled to a pension as part of that employment. Loyalty is now seen as a weakness and “more fool you” for thinking that you would actually get what you had earned. My pension entitlement has been stolen and should be restored in full.*

The representative complainants – Mr D

2.18. The third representative complainant is Mr D. He is currently 62 years old, having been born in November 1943. He is married with two sons in their thirties and lives in Devon.

2.19. He has worked for his current employer, an electrical instrument and fibre optics company – currently as an engineering draughtsman – since 1961 and he joined the pension scheme on 1 April 1965, as soon as he was allowed to do so, after having been assured by the company and by official leaflets that it was in his best interests to do so.
2.20. Mr D had made a number of requests for pension forecasts – including in 1988 and 1995 – and had always kept a keen eye on his pension rights. After the previous owners decided to ‘freeze’ the scheme in 1999 and before the commencement of wind-up, he was given an estimate of what transfer value he might receive if he were to leave the scheme, but was advised by the scheme actuaries not to leave the scheme as he would suffer financial loss if he did so.

2.21. After a change in ownership in 2000, the company – whose current owners are still trading – decided to close the pension scheme and commence wind-up. The scheme was underfunded and trustees had obtained a court order to establish that the sponsoring employer had to pay to the scheme approximately £2.5 million over no more than ten years.

2.22. Mr D told me:

*My complaint is that the Government failed in their duty to ensure that my pension was protected in the way that the Government had told me that it was. The Government failed to warn me of any risks to my contributions as a result of my scheme winding up... The Government failed to place any risk warnings on its own assurances about the security of schemes like mine... The loss to myself and family is almost incalculable. My retirement is now completely unknown and in tatters. After paying into a pension scheme all my working life and providing for my retirement as the Government told me to do, I shall receive very little if anything of my entitlement.*

2.23. He continued:

*I feel that the Government should be responsible for making good the damage done by its actions and restore my pension in full. Had I ever been warned of the risks involved, I would never have continued my contributions to the scheme... If the law had done what the Government assured people like me it would do, I would not have suffered these losses.*

2.24. Mr D told me that the effects of the past five years, since he was informed that his pension was unlikely to be paid, despite official assurances that it was protected and guaranteed, had had a serious effect on his health and had caused severe stress to his wife and himself.

2.25. He concluded by telling me that ‘we believed Government when they said our pensions were safe and there was no mention of risks. We have been robbed of our pensions and only full compensation will correct this injustice and restore faith in pension schemes’.

The representative complainants – Mr B

2.26. The fourth representative complainant is Mr B, who lives in Tyne and Wear, although the firm for which he worked was based in the East Midlands. He is currently 63, having been born in May 1942.

2.27. He worked for his former employer, a shoe manufacturer, for 36 years. The firm is now insolvent. Mr B, who is married with adult children, also made additional voluntary contributions to his scheme totalling £25,000.

2.28. He had been for many years a trade union activist and had been the union convenor for some time prior to losing his job. The union had kept an information desk on the shop floor, which had included information about the company scheme from the scheme itself but also from official Government sources. The trade union had actively encouraged membership of the pension scheme. Mr B had become a member nominated trustee of the scheme in 1999.
2.29. Following redundancy, Mr B had had to sell his house and move to a smaller property elsewhere in the country and also had had to take on part-time and then night work, some of it of a heavy manual kind, in order to keep sufficient income coming into the household.

2.30. In his original complaint, Mr B told me:

Along with other trustees of the scheme, I had been given an OPRA booklet, 'A Guide for Pension Scheme Trustees' – reference PST/SAC/COI/797. I read this book thoroughly: as both a trustee and the [union] convenor, it was my duty to do so, so I could advise members appropriately. It convinced me that my pension and those of my colleagues was quite safe so long as the scheme was funded to the legal requirement...

The booklet said that “the MFR refers to the minimum amount of funds that should be in the scheme at any one time in order to meet the scheme's liabilities if it were to be discontinued”. Nothing could have been more convincing. This single line alone gave me what I thought was justified confidence in the scheme.

Unfortunately, it was also totally wrong. It could and should have warned that if the scheme were wound up our assets would be used to pay existing pensions. I understand that later editions of the booklet have made this clear but far too late for me to be able to warn my colleagues.

2.31. He continued:

In our case, the company had made little or no profit for several years and insolvency was widely expected. Our scheme was, however, funded to the required level. None of the deferred pensioners would have risked their most precious assets on the unlikely financial survival of their former employer without the misleading assurances such as those given to us by OPRA and other Government organisations.

2.32. Mr B has now been told that he is likely to lose approximately 90% of his pension benefits. He told me that the 'only fair solution' to this situation would be 'the full restoration of the pensions of myself and my colleagues'.

Comments by other complainants

2.33. The comments made by the representative complainants were similar to the many others I have received, all of which I have reviewed.

2.34. Some of the more typical of these – in relation to the security provided by the Minimum Funding Requirement (MFR), which was the statutory mechanism against which pension schemes had to fund – include:

- Due to my age I was very interested in pensions and I had submitted an application for early retirement prior to the demise of the company but it went into receivership prior to them approving my application. It was common knowledge through government publications that, with the MFR, final salary schemes were guaranteed... The Trustees told me that I was one of the lucky ones to be left in a final salary scheme as there was no risk involved due to the measures the Government had put in place since the Maxwell scandal [male, active member at wind-up, insolvent employer scheme];

- When I asked our trustees what would happen if my company was not taken over but instead went bust, I was told that the law put in place after the Maxwell scandal would safeguard and protect our pensions [female, deferred member at wind-up, insolvent employer scheme];

- Although obviously not a pensions expert, I was aware that pension funds were kept separate from company funds and that the level of funding had to be maintained to meet a minimum level set by the Government. I naturally thought that this was to ensure that schemes were always adequately funded, a
belief that was reinforced by the leaflets I read which did not mention any risk. My scheme wound up fully funded to the Government’s level but I will still lose at least half my pension rights [male, deferred member at wind-up, solvent employer scheme]; and

- We received both scheme documentation and official leaflets, including ‘A Guide to Your Pension Options’ (copy enclosed). The scheme material said that the law protected our pensions and the official material said it was safe, guaranteed and protected. It also strongly recommended that people join their employer’s scheme but without informing us that there was a risk to doing so or that we needed to know about the financial strength of the company. The situation we now find ourselves in was a complete surprise. At no time did the Government indicate, let alone tell us, that our savings might be at risk [couple, both active members of an insolvent employer scheme].

2.35. Other points made by many complainants included:

(i) that official literature had led people to believe that only certain questions needed to be asked about their scheme: ‘I asked every year whether my scheme was funded to the legal requirement. I was told every year it was and sometimes more than that... From what I had read, that meant to me that the scheme had enough money to meet its liabilities to pay us our pensions’;

(ii) that many respondents feel bitter that public sector final salary schemes are ‘guaranteed’ where theirs proved not to be: ‘it seems to me now that the only pension that is safe and secure is the one government officials provide for themselves. Those responsible for the leaflets which misled me and for the law and policy which created this mess still have their pensions intact and guaranteed – is this right?’

Another said: ‘I have paid for not only my pension but at least two others for all of my working life... the Civil Service, MPs and Judges pensions, who all have a guaranteed pension paid out of my wage packet via taxes... [and] the local authority workers pensions... paid for from the rates which I pay. In total contrast, there is my own pension now not worth the paper the promises were made on – promised to me as safe, secure and guaranteed by the very people who take their pensions from the taxes I pay’;

(iii) that, had individuals known that all of their pension was not safe, they would have made other arrangements: ‘I made voluntary contributions without knowing that it would be safer to use that additional money to diversify my savings and spread the risk’; and

(iv) that the ‘political’ message had been that the Maxwell ‘scandal’ had been due to insufficient statutory protection and that the new laws had been introduced to end the possibility of ‘another Maxwell’: ‘The whole thrust of the material I saw was that the role of Government and the law was to protect our pension rights against employers who did not fulfil their obligations. Now I am told that it is not the role of Government to ensure that my employer, who chose to close the scheme, should make good his promise’.

The representative complaints – the maladministration alleged

2.36. Speaking on behalf of all those who complained to me, the four representative complainants alleged:

(i) that DWP and OPRA did not take proper care when informing the trustees and members of defined benefit occupational
pension schemes about the degree of security of the pension rights accrued by members of a scheme. In particular, both bodies failed to warn of the risks to non-pensioner members of such schemes in the event that a scheme was wound-up. Instead, the publications and other statements of such bodies appeared to provide unqualified assurance that such rights were protected by law and guaranteed. As a consequence, members and trustees of schemes were led to believe that their pensions were safe when this was not necessarily the case;

(ii) that DWP and the Treasury failed to take action to draw the limitations of the protection provided by the law to the attention of scheme members even though they had been warned by the Faculty and Institute of Actuaries in May 2000 that members of occupational pension schemes were unaware of the risks to their pension rights. Instead, official publications and statements continued to provide reassurance without the mention of such risks;

(iii) that DWP Ministers approved relaxations in the actuarial calculations underpinning the statutory requirement for minimum scheme funding in 1998 and 2002, without having due regard to the effect that these relaxations would have on the security of pension scheme rights should a scheme be wound-up with insufficient assets and also without ensuring that scheme members and trustees were made aware that the effect of these changes was a further reduction in the security of their rights; and

(iv) that NICO was responsible for delays in reconciling pension entitlements in respect of the members of schemes which were in the process of winding-up, which had had a significant effect on keeping such schemes in wind-up for longer than necessary. These delays had led to further financial loss to scheme members arising from additional administrative costs and in consequence of reducing annuity rates during the period of delay.

2.37. The representative complainants considered that all of the above constituted maladministration which had caused them, and people in a similar position to them, injustice.

The representative complaints – the injustice claimed

2.38. The representative complainants complained that members of schemes had not been able to make informed decisions about whether to diversify their pension and savings provision, about whether to remain in schemes when they left the employment of the sponsoring company, and when making other choices such as seeking new employment with a more secure employer, taking early retirement, or agreeing to stay at work beyond normal scheme retirement age.

2.39. They also complained that scheme trustees had been prevented from fulfilling their obligations to scheme members and that their professional reputation had suffered as a result.

2.40. Others who have complained to me have told me of the significant losses they have suffered, of the outrage they feel that this has been allowed to happen, and of the effects that these events have had on their health, their financial security, their future plans, and on the other members of their families. They have also told me of their loss of faith – in Government, in their employer, and in the wider pension system.

2.41. I am told that two scheme members have committed suicide since learning that they would not receive their full pension. I am also aware that at least two of the individuals who
complained to me have passed away since my investigation began.

2.42. One of these was receiving a pension of approximately £10 per week – when he should have been entitled to a full ill-health early retirement pension – in the period before he died. A member of his scheme for more than thirty years, he should have received on retirement an annual pension of more than £10,000, plus a substantial lump sum; his scheme should also have provided a widow’s pension.

2.43. The other was a member of his scheme for 29 years and, similarly, would have been entitled to an annual pension of more than £10,000 and also a widow’s pension. Even if he had survived and qualified for the FAS, on current criteria his widow will not receive any pension at all from his scheme – and I understand that she may not qualify for a full state pension in her own right.

2.44. It is impossible to recite here all of the personal stories that I have been told. Some examples of the cases that I have seen include:

- that of a former manager of a small firm, who, when leaving the firm a few years prior to his scheme retirement age, decided to leave his pension within the scheme, believing it to be safe. He has since lost more than two-thirds of his expected pension and will not be eligible for FAS ’assistance’;

- that of a woman who worked for the same company for 27 years and who had been a member nominated trustee of her scheme. She has lost all of her pension. She told me:

  *I was always told that my pension was safe, but now I can see that I would have been better off never putting money into it, because the law says that my money has to be used to pay other people’s pensions and not mine. I don’t know what I am going to do for the future. I have lost so much and nobody ever warned me that this could happen; and*

- that of a man who worked for the same company for 43 years, who had expected to retire on an annual pension of £34,000 but who has been told that, due to the severe under-funding of the scheme, he will only receive an unknown proportion of his Guaranteed Minimum Pension and nothing at all from all of his contributions to the scheme.

2.45. However, complainants have told me that the injustice they feel is not ‘merely’ such financial loss, enormous though such financial loss is in most cases. There are three other aspects of the injustice they claim.

2.46. The first is a deep sense of outrage at the way that their pensions, in words that have been used to me on many occasions, ‘have been stolen’. A common theme among the many letters and other communications I have received was anger, directed both at Government and at employers, that the pension system had failed scheme members.

2.47. Many individuals drew my attention to the assurances given by Government when the regime created by the Pensions Act 1995 was established. They told me that this regime – which it had been said aimed to provide protection for individual pension scheme members – had been introduced as a result of
the Maxwell scandal in order to prevent pension scheme assets being plundered by unscrupulous employers but also to provide security for individuals. That regime had demonstrably and comprehensively failed, they said.

2.48. The second additional aspect of the injustice claimed relates to a sense that individual members of final salary schemes had been prevented from making informed choices about their provision for retirement and about their other financial planning.

2.49. Many individuals told me that, in a context in which Government, employers, and the pensions industry were all promoting membership of occupational pension schemes and where those responsible for the legal, regulatory and administrative frameworks that underpinned the security of such schemes were encouraging membership without mention of risk, they had been misled into making extremely critical financial decisions without any knowledge of the right questions to ask. This, in the view of complainants, amounted to misdirection and a dereliction of a duty on public bodies to provide balanced information about the statutory regime for pensions protection which they had introduced, which they operated and for which they were wholly responsible.

2.50. The final additional aspect of the injustice claimed by individuals was the profound effects that the loss of their pension rights had had on their self-respect and their family life.

2.51. Many individuals told me that the uncertainty and distress that they had suffered was compounded by a sense that they as individuals had failed their families by having been lulled into a sense of false security by official statements about their pensions. This also had been reinforced by the effects that the loss of their pension had had on other members of their families, many of whom had had to make a larger financial contribution to family income than expected, had had their own plans ruined, or who had had to deal with the stress and anxiety caused to the scheme member.

2.52. All of the above constitutes the injustice claimed by complainants.

**Representative complaints – the remedy sought**

2.53. The representative complainants considered that the FAS does not constitute an adequate remedy for the injustice that they claim to have suffered due to maladministration by the public bodies responsible for occupational pensions policy and regulation.

2.54. They consider that this is the case because the FAS will not cover schemes where the employer is still solvent; nor will it cover many members of schemes even where the employer is insolvent. Furthermore, such ‘assistance’ as may be provided by the FAS will not cover the whole loss suffered by even the minority covered by its terms.

2.55. They thus seek for themselves – and for others in a similar position to them – the restoration of their full pension and associated benefits (such as life cover) – and also financial recognition of the distress, inconvenience and uncertainty caused to them by the maladministration they allege.

**The Government’s initial response to the complaints**

2.56. Where I propose to conduct an investigation into any complaint, I am required, by section 7(1) of the 1967 Act, to afford to the principal officer of the department or public body whose actions form the subject matter of the complaint an opportunity to comment on the allegations contained in that complaint.

2.57. I received responses to the representative complaints from the Treasury, the DWP, OPRA and what was then the Inland Revenue on 20 December 2004.
Treasury response
2.58. The then Permanent Secretary of the Treasury noted that the complaints related to matters which were not the policy responsibility of the Treasury. Policy responsibility for occupational pension schemes and the MFR lay not with it but with DWP. He said that the Treasury takes an interest in issues such as these which might have an impact on those policy areas for which it is responsible, but that its sole focus was on monitoring such impact.

2.59. In the case of the MFR, the Treasury’s involvement had been in assessing the impact of the MFR on institutional investment and the effects that the various options for reform of the MFR might have had on financial markets.

2.60. The Treasury had worked jointly with DWP on a series of consultation documents and public statements on these issues, but that had not meant that at any time responsibility for the matters under investigation were the policy responsibility of the Treasury; still less had it undertaken any administrative actions in relation to the matters complained about that might be subject to an investigation by me.

2.61. The Permanent Secretary said that the Treasury had never advised scheme trustees and/or scheme members directly on any matter related to occupational pensions and that this would not have been appropriate as another Government department had policy responsibility for such matters.

2.62. That being the case, the investigation was more properly directed at DWP, although the Treasury had contributed to the DWP response. As I have said above, I accepted that this investigation is properly directed at DWP, OPRA and NICO.

DWP response
2.63. The then Permanent Secretary of DWP said that the Government did not accept that any of the complaints were well-founded or that the facts supported the allegations of maladministration made by complainants. He said that it believed that the complaints were based on a substantive misconception of the role of Government in relation to individual private pension schemes and their members.

2.64. He said that neither DWP nor the Treasury had a legal duty to provide information to pension scheme members, generally or in relation specifically to the MFR, and that this was the role of scheme trustees. Notwithstanding this, DWP had to a limited extent provided generic information to the general public about the various methods of saving for retirement, including occupational pension schemes, through its leaflets.

2.65. The DWP leaflets cited by complainants had therefore been public information leaflets which had provided a general introduction to occupational pension schemes. They had not been intended – as they had made clear – to provide comprehensive advice or a legally complete statement about final salary schemes. Rather they were intended to be a general guide to encourage people to think about saving for their retirement. The leaflets had been intended only to give an outline explanation of such schemes and as such could not have constituted individual advice to members about their pension choices, or their rights and liabilities through membership of a scheme.

2.66. The then Permanent Secretary said that, despite this, the information provided in them had been accurate and – in the context of a general, introductory leaflet – appropriate.

2.67. Given their essentially ‘introductory’ nature, they were also not misleading. The leaflets had not indicated that the benefits of an occupational pension scheme were assured or
that an occupational pension would necessarily be the most suitable arrangement for everyone.

2.68. The then Permanent Secretary said that it would not have been responsible or appropriate for general leaflets of this kind to have covered what were accepted to be complex aspects of funding and investment risk which might differ significantly from one scheme to another.

2.69. In addition, while such leaflets were available to the general public through DWP’s pension information order line, through its websites, and from its Pension Centres, DWP did not target the distribution of such leaflets directly or through the pensions industry to individuals or to schemes.

2.70. The then Permanent Secretary said that he did not think it appropriate for individuals to be encouraged to take important decisions depending on differing assessments of financial risk on the basis of general public information of this sort. He said that the degree of risk and whether that risk may justify an individual taking action which itself incurs a different risk is particularly complicated and difficult to explain.

2.71. Such general leaflets did not seek – nor could they reasonably do so – to detail the different sort of risks, such as the longevity risk associated with deciding when to purchase an annuity or such as stock market investment risks, that exist in relation to personal investment decisions such as those related to private pension provision.

2.72. The then Permanent Secretary said that anyone reading the leaflets could not have reasonably thought that they were getting a complete picture of the issues surrounding the security of occupational pension schemes and, in particular, the security of their own scheme by so doing.

2.73. However, he said that DWP leaflets did sometimes refer to matters where the Government was aware of current public concerns and where it was taking or had taken specific action to address such concern. The Permanent Secretary explained that that was why the April 2004 edition of Occupational Pensions: Your Guide had included a new statement about the problems being caused by insolvent wind-ups and the intended establishment of the PPF, which at that time had recently been introduced to Parliament in the Pensions Bill.

2.74. The then Permanent Secretary said that his Department had recognised widespread concerns from a number of groups about the way the MFR was working and in March 1999 it had commissioned a report on the MFR from the Faculty and Institute of Actuaries. While mainly concerned with the technical working of the MFR, the report also considered the question of disclosure of information on the level of security provided by the MFR to scheme members. It recommended that there should be full and clear disclosure of the limitations of the MFR test and of the consequences for accrued rights if a scheme should be wound up. However, the Permanent Secretary pointed out that the report had itself recognised that full and clear disclosure needed to be carefully handled and that it had also said that further work on the form and manner of any disclosure was still necessary.

2.75. He said that, even were the Government to accept that it had a responsibility to communicate directly with scheme members (which it did not), it would have been inappropriate and possibly injurious to scheme members to have attempted to have communicated specific warnings until this further work had been completed.
2.76. The then Permanent Secretary said that DWP had taken forward consideration of the disclosure issue in parallel to its work on reviewing and developing proposals for the replacement of the MFR itself, which had been in part undertaken by a Consultation Panel. He said that the Government had been open about this work and had recognised publicly the concerns that people had raised about the MFR.

2.77. He said that at no time had anyone involved in the formal consultation on this reform work suggested that DWP should issue information direct to scheme members (or indeed the general public) about the limitations of the MFR as a method of securing scheme benefits. The Consultation Panel, set up by the Department to assist it in the review of the MFR and consisting of experts from different parts of the pensions industry, had recognised that communication with scheme members on funding issues was a complicated and important issue. However, there had been no consensus as to how, in what form, or at which level of detail communication with scheme members could best be achieved. Research on this issue had been commissioned by DWP in August 2002.

2.78. That research, published in February 2003, had clearly borne out concerns about unwittingly causing unnecessary alarm and possibly inappropriate responses by scheme members as a result of full disclosure.

2.79. The then Permanent Secretary said that, by the time the research had been received and considered by DWP, planning for the replacement of the MFR had been well advanced and it had been decided that, in this context, the specific issue of communication needed to be subsumed within the broader issue of how trustees should communicate information about the level of funding in a scheme once the MFR – which was widely recognised as being in need of wholesale reform – was replaced.

2.80. In relation to the changes to the MFR basis, the then Permanent Secretary said that there was a strong case for maintaining that these changes were a matter of policy not administration and that the relevant policy decisions had been taken reasonably and without maladministration.

2.81. He said that the changes to the actuarial basis underpinning the MFR calculation had been made following recommendations to do so by the Faculty and Institute of Actuaries and had been implemented through amendment of their Guidance Note (GN27). He also said that it was a misconception to state that the two changes made were designed to weaken the MFR from its original level, which had only intended to provide a limited degree of security for non-pensioner members.

2.82. The amendments had been made to ensure that the original MFR level was maintained in the light of economic and demographic trends and had been approved by Ministers on the recommendation of officials after the technical aspects of the changes had been checked with GAD.

2.83. These changes accordingly had not amounted to a weakening of the MFR from its designed level. Therefore, the then Permanent Secretary said that the concept of needing to ‘warn’ scheme members that the MFR ‘had been weakened’ had not arisen.

OPRA response

2.84. The then Chairman of OPRA said that, while OPRA accepted that their publication had contained the phrases quoted by complainants, that particular guide – and others – had made the full position clear when read as a whole and in context.
2.85. She said that OPRA had had no responsibility for communicating direct with scheme members – the responsibility for keeping them informed and up-to-date about the position of their scheme had always lain with the trustees of each scheme and OPRA had not thought it appropriate – or even possible – to bypass them in an attempt to deal directly with scheme members.

2.86. The Chairman also said that trustees of pension schemes had a responsibility to appoint professional advisers and had a duty to consider their advice on, among other matters, the technical aspects of the funding of their scheme. Moreover, trustees were under a duty to obtain actuarial valuation reports and a schedule of contributions from the scheme actuary. Regulations required that these reports had to include a statement to the effect that they did not reflect the costs of securing the liabilities by the purchase of annuities, if the scheme were wound up.

2.87. OPRA publications, including the July 1997 edition, had made clear that they were not a definitive statement of the law and that they were not a substitute for taking professional advice, which was emphasised in a number of places in each guide. The 1997 edition had been issued to those scheme trustees for whom OPRA had contact addresses, following a print run of 200,000.

2.88. The Chairman explained that, as the impact of the MFR would be gradual, as schemes had up to four years from April 1997 to prepare for their first MFR valuation, OPRA had issued a further guide in May 1999. This went into more detail about the implications of the MFR, including an explicit reference to the fact that the MFR would not ensure that all the scheme’s liabilities could be met in the event of the scheme winding up. It had also emphasised again that the guide was no substitute for getting professional advice. This guide, like all others, had been placed on the OPRA website. In addition, 40,000 copies had been printed and sent out to the trustees of all schemes to which the MFR applied.

2.89. The Chairman said that, at the time that the guides in question had first been issued, scheme surpluses rather than deficits had been the biggest issue for final salary schemes. It had been only following the collapse of the stock market and the realisation of the implications of increased longevity for the assets and liabilities of pension funds that funding deficits had become a real issue, the implications of which were still being worked through.

NICO response

2.90. The Chairman of what was then the Board of the Inland Revenue said that he accepted that the process for reconciling the entitlements of scheme members and securing their accrued rights on wind-up could take some time to complete. However, he said that he believed that this was attributable to the nature of the process rather than to any maladministration by NICO.

2.91. The time taken to reconcile the records held by schemes with national insurance records and, where appropriate, calculating Guaranteed Minimum Pension (GMP) amounts depended on a number of factors. These included the number of members, both past and present, in a scheme; the state of the records held by the scheme; and how quickly scheme administrators replied to queries from NICO.

2.92. There was, the Chairman said, considerable potential for differences between NICO’s records and those held by a scheme, especially in relation to the earnings recorded for each member. He said that employers had to notify both the scheme administrator and NICO of the earnings for each employee but often would change the amount recorded following enquiries from, or errors identified by, NICO – without
informing the pension scheme of the revised figures. Such discrepancies were often only identified on retirement, transfer or wind-up, when GMP figures were calculated.

2.93. The Chairman explained that, in the late 1990s, NICO had experienced difficulties in the changeover to their new computer system – known as NIRS2. This had had an effect on the reconciliation process, as NICO had been unable to provide computer-generated scheme lists and entitlements. However, NICO had introduced alternative arrangements where scheme administrators and/or trustees could ask for clerically prepared calculations in what the schemes considered to be priority cases.

2.94. He said that the problems with NIRS2 and the availability of the alternative service had been publicised widely throughout the pensions industry and that he therefore did not believe that they had had any significant impact on the reconciliation process.

2.95. The Chairman recognised that annuity rates had reduced in the early 1990s, and that therefore, where two schemes started the wind-up process on the same day, a scheme that completed wind-up in the 1980s would have got a better rate than one that completed in the 1990s.

2.96. However, he said that the reasons for delay in winding-up were due to many factors beyond the control of NICO. These included the need sometimes for trustees to take legal action against a creditor, such as the sponsoring employer, so as to realise all a scheme’s assets.

2.97. The Chairman said that he was satisfied that NICO had done everything possible it could have done, including the introduction of a number of local initiatives designed to progress winding-up cases within reasonable timescales.

Launch of investigation

2.98. Having received responses from the bodies under investigation, and not being satisfied that those responses had resolved the complaints or provided an explanation of the relevant facts that cleared up the issues, I decided to continue my investigation.

2.99. The next three chapters of this report set out the results of my investigation. They focus, first, on the results of the further enquiries I made as part of my investigation; secondly, on the facts my investigation uncovered through consideration of the relevant documentary and other related evidence; and, finally, on my findings in relation to the complaints.

2.100. Before dealing with these matters, I will set out the approach I have used to assist me to determine whether to uphold the complaints I have investigated.

My approach to maladministration

2.101. No definition of maladministration was provided in the 1967 Act, from which I derive my powers. Indeed, my predecessors have largely resisted attempts to ‘define’ rigidly the concept, as they considered that this might lead to an overly restrictive view of the types of complaint that my Office might consider – and also to situations in which rigid definitions became easily outdated.

2.102. However, in the Second Reading debate on the Bill that became the 1967 Act on 18 October 1966, Richard Crossman (the then Leader of the House of Commons) said that an attempt to list the qualities that might constitute maladministration would include bias, neglect, inattention, delay, incompetence, inaptitude, perversity, turpitude, arbitrariness and, in his words, ‘and so on’.

2.103. One of my predecessors also added to this list in what he said was more ‘modern’ language –
in his Annual Report to Parliament for the year 1993. He added the following traits: rudeness; an unwillingness to treat an individual as a person with rights; a refusal to answer reasonable questions; neglecting to inform an individual on request of his or her rights or entitlement; knowingly giving advice which is misleading or inadequate; ignoring valid advice or overruling considerations which would produce an uncomfortable result for the person overruling; offering no redress or manifestly disproportionate redress; showing bias whether because of colour, sex, or any other grounds; an omission to notify those who thereby lost a right of appeal; a refusal to inform adequately of the right of appeal; faulty procedures; the failure to monitor compliance with adequate procedures; cavalier disregard of guidance which was intended to be followed in the interest of the equitable treatment of those who use a service; partiality; and failure to mitigate the effects of rigid adherence to the letter of the law where that produces manifestly inequitable treatment.

2.104. However, it has been a commonly held precept of all Ombudsmen that the determination of whether maladministration has occurred is always related to the specific circumstances of each case.

2.105. The focus of the complaints within my jurisdiction that I have investigated is threefold and is related, first, to whether the bodies under investigation misled or misdirected complainants as to the security of their pension through the information provided by those bodies to the public. A second focus is whether those public bodies took various decisions that reduced such security without informing those affected of the consequences of those decisions; and the final focus is on whether public bodies have been responsible for unreasonable delays in resolving the winding-up of certain pension schemes.

2.106. Having considered the nature of the complaints within the context I have described above, my approach to determining whether maladministration occurred will be to establish the following:

(i) whether information provided by the bodies under investigation was clear, complete, consistent and accurate;

(ii) whether the bodies under investigation took the disputed decisions about the MFR and the disclosure of risk to scheme members without maladministration – that is, reasonably and with due regard to all relevant considerations; and

(iii) whether the bodies under investigation undertook their responsibilities in relation to the process of winding-up certain contracted-out final salary pension schemes appropriately – that is, without undue delay or other administrative error.

2.107. I now turn to consider the evidence uncovered by my investigation and on which I will base my assessment of the above questions.
3. Further enquiries

Introduction

3.1. This chapter sets out the results of the further enquiries I made as part of my investigation, to assist me to gain a better understanding of the complaints.

3.2. Before describing that work, I should explain that, as the matters which formed the subject of this investigation are complex and were often technical, I have treated Dr Ros Altmann – an investment expert, investment banker and economist, adviser to the pensions industry, and Governor of the London School of Economics – as the advocate for complainants. Complainants had requested that I do so and she had also been mandated to act on behalf of the action group representing a large number of individuals affected by the wind-up of their schemes.

3.3. The further enquiries I made as part of this investigation had the following key elements:

(i) we conducted a survey of every individual complainant registered with us to establish what their detailed position was, how the wind-up of their scheme had affected them, and the degree to which the FAS might remedy their losses. I received 198 responses to that survey and the key results from those responses are set out below;

(ii) Dr Ros Altmann submitted a considerable amount of evidence on behalf of complainants and provided comments on the main aspects of the response to their complaints by the bodies under investigation;

(iii) my investigator interviewed the four representative complainants, who provided valuable insight into their complaints. The results of these interviews are incorporated into the material set out in other chapters of this report;

(iv) we asked the bodies under investigation for further evidence and for their views on some of the more detailed allegations made by Dr Altmann and complainants during the investigation, which the Government provided on several occasions;

(v) we scrutinised the other written submissions of complainants which were held on our files, which have informed other chapters of this report, especially chapter 2;

(vi) my investigator also visited NICO on site, scrutinised a random sample of their files, and obtained detailed reports on action taken by NICO on the pension schemes of which the four representative complainants had been members – and also on a random selection of other schemes with which other complainants were associated;

(vii) in addition, my investigator interviewed independent trustees responsible for winding-up pension schemes to obtain an insight into their experience;

(viii) we met office-bearers of the all-party groups on Occupational Pensions and on Insurance and Financial Services and scrutinised many submissions by other Members of Parliament made on behalf of their constituents – these have been helpful in establishing the wider context in which the complaints are placed;

(ix) I sought the comments of the Association of British Insurers and of the National Association of Pension Funds, some of whose members administer occupational pension schemes, on matters related to the alleged delays in winding-up final salary schemes – those comments are set out in chapter 5 of the report;
3.4. In addition to the above, we scrutinised a considerable number of Government files, official publications and other documentary sources to establish the factual context in which the complaints were placed. The results of this scrutiny are set out in chapter 4 of the report.

3.5. I am extremely grateful to all those who assisted my investigation and for the helpful and comprehensive manner in which they did so.

3.6. The rest of this chapter sets out the key results of the survey I conducted, Dr Altmann’s first submission on behalf of complainants, the Government’s responses to my further enquiries (including the results of my investigator’s visit to NICO), further comments made by Dr Altmann, the main points made by independent trustees when my investigator interviewed them, and an outline of the actuarial advice I have received – and the actuarial profession’s comments on that advice.

**Key results of survey of complainants**

3.7. During late March, April and early May 2005, I conducted a survey, by means of a questionnaire, of all those whose complaints had been referred to me or who otherwise had contacted me about their complaint. I received 198 responses to that survey.

3.8. Of those respondents:

(i) 113 were male and 85 female;

(ii) 95 had been members of a scheme where the sponsoring employer was still solvent, 89 were members of an insolvent employer scheme, with 14 being unsure as to the status of the employer;

(iii) at the time that wind-up began, 79 had been active members of the scheme, 81 had been deferred members, 27 had been existing pensioners, 8 had been the qualifying spouse of a deceased member and 3 did not answer this question;

(iv) in relation to whether their scheme would be covered by the FAS, 45 said that it was on the indicative list of eligible schemes, 102 said that it was not on that list, and 51 said that they did not know whether their scheme might be eligible;

(v) in relation to whether they might individually be covered by the FAS, 19 said that they thought that they would qualify, 110 said that they would not qualify, and 69 did not know whether they would qualify;

(vi) 62 said that they had originally joined their scheme when membership had been a condition of employment and a further 9 said that they had been required to transfer back into their occupational scheme, following a review of their decision to buy a personal pension which had been found to be due to mis-selling; and

(vii) 63 could demonstrate that they had sought out and been provided with official literature about pensions (42 of these sent me photocopies or the originals of such material in response to my survey; another 21 had provided such with their original complaint). A further 12 could not produce an information leaflet now but could show through earlier copy correspondence that they had at one time possessed such material. 29 said that their scheme or another person had informed them that the
Government guaranteed their pension and that they had not as a result sought out other confirmation of this. 119 of the total said that they had read in one place or another that being funded to the MFR level meant that their scheme would have enough money to meet its liabilities on wind-up.

Submission by Dr Altmann
3.9. Dr Ros Altmann made a submission to me on behalf of complainants following my decision to conduct an investigation.
3.10. She said that the bodies under investigation had not taken proper care when informing the public and members of final salary occupational schemes about the security of their pensions in their employer’s plan. They had not checked carefully enough what the true situation was and had told members that their pensions were safe, guaranteed or protected when, for many groups of people, this had not been correct.
3.11. She said that, if the law did not protect them and their contributions were not actually safe, the Government should not have carelessly ‘lulled’ members of final salary pension schemes into a ‘false sense of security’. Members had thereby been denied any opportunity to protect their pensions and had had no chance to consider other courses of action which may have diversified or otherwise secured their retirement income.
3.12. Dr Altmann argued that this had been caused by the careless decisions of Ministers and officials, their inaction in the face of warnings that members had no idea about the reality of the MFR, and inaccurate and woolly statements by Government agencies in their publications and elsewhere. Government had failed to warn of the risks individuals were taking when contributing to their employer’s pension plan or when leaving retained benefits in the scheme after leaving the service of the sponsoring employer.
3.13. Dr Altmann said that Government had a responsibility to put matters right, as it had promoted and encouraged individuals to join their employer’s scheme; as many members had been originally compelled to join, which was a requirement enabled by the law; and because then, once in a scheme, Inland Revenue rules had prevented them from contributing to any other pension at the same time.
3.14. The members had subsequently lost most or all of the retirement income which they were promised by their employer’s scheme. She said that these losses could have been avoided if members had been warned that their money was not safe:

(i) those who could have retired under the rules of their scheme would never have stayed on at the request of their company — if they had known that they could lose their pension — but would have taken the pension straight away;
(ii) some members had left employment because of ill-health, but had not taken benefits because they had been assured that their pensions were safe;
(iii) others who had transferred money in from other employers’ schemes (for example, from the schemes of public sector bodies like the former National Coal Board) would have left their money in the previous schemes if they had known that they could lose it all on wind-up;
(iv) individuals who had transferred money into employer schemes from money purchase arrangements might have chosen not to do this, if they had thought that their entire money could be lost; and
(v) members who had been in their 50s, who were worried about the financial health of their employer (and in some cases had then
checked with Government agencies to find out if their pensions were safe in the scheme) could have transferred their money out if they had known that they could lose most of their expected pensions.

3.15. Dr Altmann said that the Government had denied all these people the chance to protect their retirement income, by encouraging them to join their employer’s pension scheme – and by carelessly telling them that their pensions were safe and that their accrued rights were protected by law.

3.16. In relation to the specific heads of complaint:

(i) Dr Altmann pointed to the statement on page 28 of the 1997 OPRA guide for trustees, which had said ‘the MFR refers to the minimum amount of funds that should be in the scheme at any one time in order to meet the schemes liabilities if it were to be discontinued’. She explained that this statement was untrue and the careless wording of these booklets, sent to trustees who would naturally expect the information from OPRA, the regulatory body, to be reliable, amounted to maladministration – as the MFR had never been designed to ensure that the assets of the scheme would be sufficient to meet liabilities on discontinuance. It had only been designed to be adequate for meeting the liabilities of pensioners and to have an even chance of meeting the accrued pension liabilities of those not yet retired. Thus, the regulator sent out a booklet to scheme trustees, which the trustees would have been reasonably expected to rely upon as being correct, and which led the trustees to believe 100% MFR funding meant adequate funds to meet all liabilities on wind-up;

(ii) She also said that the impact of statutory priority orders and the costs of buy-out had not been mentioned in the OPRA booklet, yet they were significant in terms of members’ benefits on discontinuance. The trustees, who would have been unaware that the information from the regulator was not complete, relied on this and passed on incorrect information to members;

(iii) Dr Altmann also pointed to the wording of various DWP leaflets, including pre-2004 editions of ‘Occupational Pensions: Your Guide’, which she said had contained misleading statements about the protection and security afforded by the law and the MFR to accrued pension rights in final salary schemes. She said that, even though DWP was encouraging and promoting these schemes, it did not take enough care to ensure that its booklets were comprehensive or accurate. She said that DWP had not sufficiently considered the impact of these incorrect assurances of safety on all the various classes of member and had failed to ensure members were properly informed of what were the risks to their accrued rights; and

(iv) She also pointed to the report of the actuarial profession, which had highlighted that scheme members and trustees generally believed that the MFR offered them full protection and its recommendation that the Government should disclose to members what would happen to their pensions if their scheme wound up under-funded. She said that the Government had said that it wanted to help people understand their pension rights. However, if that were so and if there was no guarantee that these rights would be delivered by their scheme, she said that it would have been in accordance with good administrative practice had DWP been
as careful as possible to ensure that scheme members were properly consulted and subsequently informed about the possible lack of security of their pensions. However, the Government’s consultation process had not included meetings or discussions with members of schemes themselves and it had failed properly to consider the true effects in all different possible circumstances of the implications of failing to warn members.

3.17. In relation to the remedy sought, Dr Altmann said that, while the Government had agreed to set up the FAS with £400 million funding (approximately £20 million a year) to offer ‘assistance’ to some of those who had lost out, this fund was not designed to fully compensate members for the losses they have suffered. It was designed to exclude several groups of members, even those who had lost as much as 90% of their pension, which was unfair in her view.

3.18. Dr Altmann said that the FAS only planned to restore some of the pensions to some of the victims. Therefore, in her view the Government had offered insufficient remedy to compensate for the damage done by its careless actions and its inexcusable inaction.

3.19. She said that instead it was her contention on behalf of complainants that the Government must compensate the victims of maladministration in full. Consideration should also be given to the financial recognition of the uncertainty, distress and adverse impact on their health which the stress of this situation had caused to the victims and their families.

The Government’s further comments

3.20. Following receipt on 20 December 2004 of the Government’s response to the complaints made by the representative complainants, and having considered the Government’s response and Dr Altmann’s submission on behalf of complainants, I asked both DWP and NICO for further information on 28 January 2005.

DWP

3.21. In order to further consider the complaints related to the actions or inaction of DWP, I asked to see the relevant DWP policy and any other files related to the production of their information leaflets (such as ‘Occupational Pensions: Your Guide’), their files related to consideration of the actuaries’ report, and their files concerning other work done in relation to the communication of information to scheme members.

3.22. In addition to this request for documentary evidence, I asked DWP three additional, specific questions.

3.23. First, I asked whether DWP considered that, as the Government’s acknowledged policy appeared to have been to promote membership of occupational pension schemes, it had a responsibility to provide clear and complete information about the principal risks to such schemes, including the risk of employer insolvency and/or scheme wind-up.

3.24. Secondly, I also asked for DWP’s comments on letters sent by Ministers to pension scheme members whose schemes had wound up under-funded in which it was said that, despite the problems suffered by members of some schemes, the Government would continue to encourage membership of occupational pension schemes.

3.25. Thirdly, I asked whether DWP considered that individuals had been entitled to rely on official publications as part of the process of making choices to opt out of (an element of) state pension provision by contracting out of the state additional pension and joining an occupational pension scheme.
3.26. The files I had requested were provided to me promptly and the results of my consideration of them (and other documentary evidence) are set out in chapter 4 of this report. In addition, I received the answers to the above additional questions, which combined the answers to the first and second questions, on 11 March 2005.

**DWP response to first and second questions**

3.27. In relation to the first question I had posed, DWP told me that the Government’s policy throughout the relevant period had been (as it remained), to encourage people to save for their retirement.

3.28. The Government believed that private pension arrangements, which were structured to offer a reliable source of income for life and which were tax-favoured in various ways to provide incentives, were one of the best ways to save for retirement.

3.29. DWP said that, while all forms of private pensions could be advantageous saving vehicles, the Government believed that what was likely to be the best arrangement, for those employees to whom it is available, was a pension — whether in the form of an occupational pension or a Group Personal Pension — to which the employer also made a contribution.

3.30. Within occupational pensions, DWP said that the Government did not have a particular preference for final salary or money purchase schemes: each might be more suitable for different employees, depending on their different types of job and career patterns.

3.31. To this extent, DWP said that the Government had encouraged membership of occupational pension schemes. However, this encouragement had had its limits. DWP said that Government policy had been — and continued to be — in the words of a Ministerial letter to which I had referred them, to ‘promote the general benefits of occupational pension provision’.

3.32. DWP said that the Ministerial letters had also made it clear that the Government saw this ‘general’ promotion of the benefits of such schemes as significantly different from the provision of advice to individuals as to their pension options.

3.33. Thus, it was DWP’s view that the Government’s policy of promoting the general benefits of occupational pensions could not be equated with, for example, a recommendation that an individual should join a particular occupational pension scheme or the promotion of a particular personal pension by an independent financial adviser.

3.34. Whilst it was the Government’s broad policy to encourage the take-up of private pensions, and particularly those with an employer contribution where this was available, the Government was not in a position to provide advice to individuals, whose circumstances would inevitably vary enormously.

3.35. DWP also said that there were particular reasons why it did not see the provision of ‘clear and comprehensive information about the principal risks’ of membership of occupational pension schemes as a concomitant responsibility of its policy of promoting the general benefits of such schemes.

3.36. This was especially so, DWP said, in relation to general leaflets like ‘Occupational Pensions: Your Guide’. DWP argued that to seek to provide such information would have been neither appropriate nor practicable in the sort of general public information material which it issued.

3.37. DWP said that all types of saving, which included all types of pension provision, were subject to a variety of potential risks. No pension arrangement, whether funded or pay-as-you-go,
could therefore offer an unconditional guarantee of specific levels of benefit many years hence.

3.38. However, DWP argued that not all risks applied, or applied to the same extent, to all types of pension arrangement. Moreover, while some risks did apply to all types of pension arrangement, their consequences might differ significantly depending on the type of arrangement. Any attempt to explain comprehensively and in a balanced way all the various risks, and the extent to which they applied to different types of pension, would have required detailed, complex and lengthy analysis of a sort which would be wholly out of place in a general information leaflet.

3.39. Furthermore, DWP said that an attempt to set this sort of material out comprehensively in general official literature about pensions would in practice create a misleadingly off-putting impression of the security of occupational pension schemes because attempting to set out all the risks relating to occupational pensions without putting them in the context of the various risks that apply to any sort of saving would in practice tend to discourage people from joining occupational pension schemes – a decision likely to be to their detriment in most cases.

3.40. In addition, DWP said that it would have been extremely difficult to describe in proportionate terms a range of risks which statistically were very unlikely to affect any individual scheme member, albeit that they might have had significant consequences for those that they did affect. Nor would the resulting document any longer resemble a general public information statement.

3.41. DWP acknowledged that its ‘Public Information Policy Statement’ included the requirement that information which DWP issued ‘must be timely, complete and correct. The Department may be held responsible if we give advice and someone relies on this to their detriment’.

3.42. However, DWP said that such timely, complete and correct information about the risks involved in pension savings in occupational pension schemes would be all but impossible in the context of general public information leaflets, as the purpose of such leaflets is primarily to provide a very general introduction to the subject of occupational pensions and to encourage individuals to obtain further information.

3.43. DWP said that it had been for this reason that its introductory leaflets had frequently referred the reader to other sources of information and, where appropriate, to independent advice.

3.44. Given their leaflets’ explicitly modest objectives and the issues about risk mentioned above, DWP said that it would have been inappropriate to seek to provide complete information about the principal risks in relation to occupational pension schemes.

DWP response to third question

3.45. DWP, in response to my third enquiry, told me that anyone contracting-out of the additional state pension must necessarily require information about state pension rules and potential entitlement as part of the background to such a decision, and it accepted that DWP had been a key source of such information during the relevant period and since then.

3.46. However, DWP said that official publications could only play a limited role in the process of deciding whether to contract-out.

3.47. In the case of occupational pension schemes, DWP’s view was that the decision on contracting-out was necessarily interlinked with the decision as to whether to join a pension
scheme. To make such a decision, any individual would need to rely on advice and information from the trustees, or from an independent financial or other adviser.

3.48. DWP said that, while the act of contracting-out may be relatively straightforward, the rules governing contracted-out as opposed to contracted-in provision – and hence any ‘better off’ calculation, particularly across the longer-term – were complex.

3.49. Government leaflets (or equivalent internet information) intended for the general public could not act, in DWP’s view, as a full legal or financial statement of an individual’s position, or cover every circumstance which might affect their decision.

3.50. DWP said that, at most, such leaflets could act as a starting point, designed to encourage individuals to start thinking about saving for their retirement and pointing them in the direction of sources of further information. These were limitations which such leaflets and related material made clear.

3.51. Given this complex set of issues, DWP said that the Government believed that it was reasonable to expect people to take further action, beyond reading a general leaflet, before taking financial decisions with potentially significant long-term consequences for themselves.

3.52. DWP reiterated its acceptance that the information contained in its official publications should be accurate. However, it said that it did not follow that it would be reasonable for members of the public to treat such publications as being comprehensive or as providing individual advice.

3.53. DWP was firmly of the view that it would be unreasonable for the Government to be expected to take responsibility for financial decisions made (or not made) by individuals on the basis of their assumptions about circumstances not mentioned in official literature they had read:

(i) where they had relied exclusively on such literature; and
(ii) had taken no steps to obtain financial advice on the issue; nor even
(iii) confirmed their understanding of the position with DWP.

3.54. DWP said that it followed that, while it was accepted that official publications may provide a convenient starting point for individuals when considering whether to opt out of an element of state pension provision, general information leaflets could provide no more than such a starting point.

3.55. DWP said that it did not believe that it would be reasonable for an individual to rely upon general public information leaflets in isolation when making such a decision.

NICO

3.56. At the same time, I asked NICO for further information. Specifically, I asked them to provide me with a list of all of the wound-up schemes that NICO had worked on (or was still working on) to reconcile GMP entitlements during the relevant period; the dates at which each scheme had wound up (and the date when NICO had been informed that each had wound up); the total number, if known, and categorisation of scheme members covered by this work; the number of schemes and individuals affected by situations where the reconciliation process had been completed and the number where such work had not been completed; and a detailed report on the work done to date by NICO in relation to each of the four schemes relevant to the four representative complainants for this investigation – and an indication of the current position on each scheme.
3.57. NICO said that not all the statistical information I had asked for was available in the format in which I had requested it. However, they provided me with some statistics to help me understand the context for their handling of schemes winding-up and also offered my investigator the opportunity to visit NICO and to have access to their files and systems.

3.58. My investigator visited NICO on 3 March 2005. He was provided with access to NICO staff and their files and was able to read a random selection of case files and to interrogate their computer system freely.

3.59. As follow-up to that visit, in addition to the detailed scrutiny of the files of the four schemes of which the representative complainants were members, I asked for a report on NICO's handling of a random selection of 22 schemes of which other complainants were members and also for further statistical information.

**NICO's handling of the four representative schemes**

3.60. In relation to NICO’s handling of the scheme of which Mr J was a member – which had approximately 500 members – NICO had not been informed that the scheme had ceased for approximately twelve months after it had started wind-up.

3.61. In addition, I saw from the file that the scheme administrators had requested that NICO only take action on cases which the administrators identified as a priority to NICO – and then only once they were in a position to ask detailed questions about scheme members' entitlements. This did not happen for a further nine months.

3.62. Once the administrators sent in queries for resolution by NICO in relation to 22 members, NICO took action to resolve nine of those cases and asked for further information about the remainder in order for it to be able to resolve the queries. This took NICO sixteen working days to complete.

3.63. Similarly, the process of resolving other queries involved ongoing dialogue between the administrators and NICO but I saw that in all cases NICO responded to enquiries within reasonable timescales.

3.64. With Mr G’s scheme – which had just over 1,000 members – it took the administrators just over nine months to inform NICO that the scheme was winding up. It also was a complex scheme, which had had more than one sponsoring employer and had involved both final salary and mixed benefit pensions in it.

3.65. Through consideration of NICO’s file, I identified two stages to the process of reconciliation – the first, initial stage encountered problems in relation to NICO’s computer system. However, those appeared to be resolved quickly.

3.66. Furthermore, the principal delay in the initial stage of NICO’s handling of this case related to a history of incorrect payments of national insurance contributions since April 1997 by one of the sponsoring employers, which had meant that age related rebates had not been properly recorded by the scheme for every member. This took NICO just over six months to rectify, which, given the circumstances, did not appear to be unreasonable.

3.67. Once this had been resolved, NICO responded, in the second stage of its handling, to each query from the scheme administrators within five working days.

3.68. In relation to the scheme of which Mr D was a member – which had approximately 400 members – the administrators took just over ten months to inform NICO that the scheme had commenced wind-up.
3.69. I saw from the file that the explanation provided for this delay was that there had been a change in scheme actuary and that it had taken some time for the relevant files and records to be transferred to the new actuary. In addition, the original notification did not give NICO enough information to take immediate action and further information had to be sought.

3.70. The information provided to NICO in due course raised more questions about whether the scheme had provided the correct information, including an accurate reference number. It was also clear from the volume and nature of the enquiries made by the scheme administrator of NICO that considerable discrepancies existed between the records of the scheme and those held by NICO.

3.71. Methods of preservation of pension rights have now been secured for those members about whom sufficient and consistent information is held and those were provided within reasonable timescales, given the administrative problems outlined above. However, I note that work continues to resolve the problems in reconciling records for other individuals.

3.72. Finally, with regard to the scheme of which Mr B was a member – which had approximately 800 members – the first notice that NICO had that the scheme had ceased and was in wind-up was provided in a telephone call from the scheme actuary more than ten months after that had happened. Three weeks later, NICO received a letter from the official receiver which advised that the employer had gone into receivership at approximately the same time. NICO was then informed formally by letter two weeks later that wind-up had commenced.

3.73. It soon became apparent that the sponsoring employer, which had been formed from a number of mergers, had not notified either the scheme or NICO of the transfer of certain members from one scheme to another. In addition, NICO identified revaluation discrepancies between the scheme’s records and its own.

3.74. Over the next year, correspondence and information was exchanged to rectify the discrepancies and to establish exactly which individuals of which former components of the company were members of the scheme.

3.75. I note that work continues to resolve these issues and also to explore deemed buy-back. However, the scheme was removed from NICO’s priority list on 18 August 2004 at the request of the scheme administrators and was replaced on that list by another scheme for which those administrators were responsible.

**NICO’s handling of the random sample of other schemes**

3.76. Having examined the handling of the other sample schemes, a similar pattern emerged. Many of the schemes whose members have complained to me were not notified to NICO as being in wind-up until well over one year had elapsed.

3.77. Similarly, the reconciliation process in relation to many of the schemes suffered from the existence of inconsistent records and from historical mistakes made by the personnel departments of the sponsoring employers.

3.78. While NICO computer problems did appear to figure in some of the delays, in all cases I have seen those problems were ameliorated by alternative clerical arrangements put in place by NICO or by other solutions. In the one case where it appears that such computer issues were serious, other factors meant that no progress would have been able to have been made on that scheme even had no computer issues emerged.

3.79. In many of the cases, the different parties responded relatively quickly to each others’
enquiries or requests for information. However, that was not always the case, despite attempts, usually by NICO, to establish closer liaison arrangements between NICO and the scheme administrators, their advisers, or those responsible for the affairs of insolvent employers.

3.80. None of the schemes I have observed were wound-up quickly and none of the scheme cessations I examined were notified to NICO particularly promptly, which led to delay from the outset.

Statistical information obtained from NICO files

3.81. In order to satisfy myself that the delays in completing wind-up and securing the benefits of scheme members were not wholly or mainly attributable to unreasonable delay or other maladministration by NICO on a wider or systemic basis, I asked NICO to provide me with additional information about their total workload – concerning the time taken by scheme administrators or independent trustees to inform NICO that a scheme was in wind-up.

3.82. The information we obtained from their computerised records showed that, at 22 March 2005, of the 8,513 schemes on which they were then working:

- in only 1,478 cases had the scheme notified NICO that it was winding-up, thus initiating the reconciliation process, within three months of scheme cessation;
- those notifying NICO within six months totalled 3,453 – with those within one year coming to 4,925; and
- in 1,646 cases it had taken more than two years from scheme cessation to notification.

3.83. The average time taken to notify NICO – thus launching the reconciliation process – was just over 14 months and more than 40% of schemes took longer than one year to provide notification.

3.84. In relation to NICO’s more recent workload, the position as at 18 October 2005 showed that the average taken was 14.19 months, with exactly 40% taking more than one year to notify NICO. At 15 January 2006, the position was, respectively, 15 months and 40%.

Further submissions by Dr Altmann

3.85. I asked Dr Altmann for her observations on the Government’s response to the complaints and on DWP’s further comments. She made further submissions to me on 18 March 2005 and on 2 August 2005.

3.86. She said that the individuals who had lost their pension rights through scheme wind-up both had been encouraged by public bodies to join their occupational scheme and had had the schemes promoted to them through official publications.

3.87. Dr Altmann argued that this encouragement and promotion constituted more than the provision of general and introductory information. In addition, when giving such encouragement and promotion, the Government had a duty to be balanced and fair in the information provided, even if it were of a general nature.

3.88. While noting that DWP in their response – and also in their publications – had made much of the fact that occupational schemes were not suitable for everyone, she said that the examples given – people who changed jobs often or who had low incomes – had been insufficient and had been focused on the individual circumstances of a potential member of an occupational pension scheme.

3.89. Dr Altmann argued that that was not the substance of the complaints. The issue underlying them was not whether individuals had been told to join a scheme that was unsuitable
for their needs due to their own circumstances, but rather that no warning at all of the risks to their pensions – based on the circumstances of the sponsoring employer of the scheme they were being encouraged to join – had been made. Indeed, they had never been told that factors beyond their control could take their pensions away and instead had been told to join schemes that had been promoted as being safe, guaranteed and protected by law.

3.90. She argued that, even where Government is only generally promoting the advantages of private pension provision, it still had a responsibility to refer, even briefly, to any major risks to an individual’s investment and not just to emphasise the benefits of belonging to a scheme.

3.91. Dr Altmann noted that even introductory material might have included one sentence which said something like ‘of course, no pension arrangement can offer an unconditional guarantee and there could be circumstances, such as if your scheme winds up, when you may not receive the full pension you are expecting’.

3.92. In any case, she said, the ‘general introductory’ leaflets had dealt with a number of other issues of detail, including the effects of moving abroad in future and the pension sharing provisions for divorced people. To have not dealt at all with the most significant risk of all – that an occupational final salary pension was only as good as the sponsoring employer who had promised to pay it on retirement – was not in accordance with good administration.

3.93. Dr Altmann accepted that it was for individuals to ask questions and to seek appropriate advice before making financial decisions. However, she said that the effect of official publicity, ministerial announcements and other Government policy had been to provide assurance that pensions were safe and that the only question that a member needed to ask was whether their scheme was funded to the MFR level. That led to a position in which people could not make informed decisions as they had not been told the correct questions to ask.

3.94. Dr Altmann said that she did not suggest that all members would have been dissuaded from joining a final salary scheme had they known the true risks – but they would have been able to take extremely important financial decisions in the light of all the information that they needed to have to make such informed choices. Some may have diversified their provision rather than make additional voluntary contributions to schemes; others may have monitored the financial strength of their employer more closely and taken action with their fellow workers to seek increased contributions from the employer.

3.95. She continued by emphasising the importance of Government decisions and the terminology that Government had used. She said that, as regards to contracted out schemes, the very name of the entitlement left little room for any doubt about the security of the pension received from the rebates, having been called by Government a ‘Guaranteed Minimum Pension’.

3.96. Dr Altmann said that this reinforced the feeling among members that their pensions were safe and protected by laws devised and overseen by Government. They had never been told by that Government that such pension rights might not actually be guaranteed nor even a minimum.

3.97. She continued by saying that the Government had also failed to carefully consider the effect that weakening the MFR would have on the security for members of schemes where a solvent employer simply chose to wind-up the pension plan, even if the employer could afford to meet the full buyout costs of providing the promised pensions.
3.98. In conclusion, she said that each part of Government had reinforced the message of the other and, even if each public body, on its own, felt that its actions were not so bad, ‘in combination the net effect was like encouraging people to bet their entire retirement income on the shares of just one company on the stock market’.

Interviews with independent trustees
3.99. My investigator met three independent trustees, each responsible for overseeing the winding-up of a large number of schemes and all operating principally within different parts of the UK. One of the trustees had discussed the issues prior to meeting my investigator with her colleagues on the representative group for independent trustees and some of her views were provided on behalf of those colleagues.

3.100. The topics covered in the interviews revolved around five questions:

- what the independent trustees considered from their experience that scheme members, trustees, administrators and professional advisers knew about the role and purpose of the MFR;
- what they considered was known by the above groups in relation to the security of pension rights on scheme wind-up and on what basis or source such knowledge had been gained;
- what the independent trustees considered had been the key challenges in resolving the wind-up of the schemes with which they had been involved;
- what their experience had been of dealing with NICO; and
- what their view of the key factors that made the process of winding-up a scheme and preserving members’ pension rights such a protracted business.

3.101. I will now describe what the independent trustees told me in relation to each question above.

The MFR
3.102. The trustees agreed that, while scheme actuaries, lawyers, the trustees who were appointed by the sponsoring employer, and other pensions professionals were generally aware of the MFR – or had access to advice about its role, purpose and effects on their scheme – neither the member nominated trustees nor the generality of the members had any developed understanding or awareness of the role and purpose of the MFR.

3.103. One trustee said that he had attended a meeting of members not long after appointment to oversee the winding up of the scheme, and had had to explain that, although the scheme was funded to the MFR level, this did not necessarily mean that it would be able to meet all of its liabilities to them. He reported incomprehension and bemusement from members, as they understood that their pensions were guaranteed so long as the scheme was ‘properly funded in law’.

3.104. One trustee referred to the common misconceptions – ‘even within the industry’ – about the MFR that had persisted up until approximately 2000, which had equated the MFR with a solvency standard. This he said was patently not the case, especially after 2000, by which time the MFR had become ‘an exceptionally weak standard’ – even though many companies were only funding – legally – to that standard.
Security of pension rights
3.105. The trustees agreed that the scheme members they had encountered had had little if any idea before the wind-up of their scheme that there was any chance that the ‘pensions promise’ would not be met in their case.

3.106. One said that many members believed that they had an ‘individual pot’ which no-one else could touch and which would fund their retirement on the basis of the final salary formula – the years spent contributing to the scheme and their final earnings before retirement or leaving the relevant employment.

3.107. Another said that the MFR had never been explained to members properly and that the existence of a statutory funding mechanism had ‘given the illusion of safety and security’. Having a funding basis established by and determined with the approval of Government seemed to give the impression that the Government was satisfied that the level prescribed was sufficient to meet the ‘pensions promise’.

Key challenges in winding-up schemes
3.108. In winding-up the schemes that they had been involved with, the trustees said that the key challenges they had faced were managing distressed people when coping with the ‘cliff-edge’ effects of the statutory priority orders on scheme members under retirement age, while ensuring that assets were realised and properly allocated to the pensioners and the members, and doing all this as speedily and with as little cost to scheme assets as possible.

Dealing with NICO
3.109. All three trustees said that they believed that NICO provided a satisfactory service within the statutory, technological and administrative confines within which it had to operate. However, these confines were substantial and led to long delays and extra costs which were not appreciated by trustees or members.

3.110. A key theme in their experience had been that NICO was not enabled within the legal framework to be flexible as regards the reconciliation of contracted-out entitlements and that this had led to long and often involved negotiations and exchanges of correspondence in relation to quite small sums of money. This had had a serious impact on the amount of time it took to wind up a scheme. One described this as leading to an ‘intransigent’ attitude and to a ‘rigid’ system. However, another said that NICO had ‘vastly improved’ its service in recent years and had tried to be as ‘transparent’ and ‘helpful’ as possible within an ‘outdated’, ‘overly complex’ and ‘totally inflexible’ legal regime. The third said that the introduction of face-to-face meetings between NICO and independent trustees to help resolve problems had been a ‘significant’ improvement.

3.111. Another common factor experienced by the trustees was that NICO’s computer infrastructure had not been all that it might in the past and that this had had a detrimental impact on the time taken to deal with even some of the less complex schemes. The problems with NIR2 had taken ‘many more months’ to resolve than had at first been expected. However, it was recognised both that this was matched by the often poor technology supporting scheme administration and also that advanced technology was no substitute for timely and accurate reporting to NICO of the data they needed, which trustees recognised had not always been forthcoming.

3.112. In relation to administration issues, the trustees recognised that the work NICO could do was heavily dependent on the quality of administration within schemes and the degree to which the records of each scheme had integrity and were kept up-to-date. It was agreed that, on appointment as independent trustee, they had found the state of scheme records to be in a variable state. One of the key factors identified
by the trustees was that, where a scheme administrator had been changed during the life of a scheme, often there had been little attempt by the old administrator to keep records up-to-date once they knew that they were to lose the business – and also the handover from old to new administrators often left much to be desired.

Factors of delay in winding-up
2.113. All the trustees agreed that a number of key factors contributed to the delay in winding-up some schemes. Such factors identified included: the need to pursue from the employer shortfalls in the funding of a scheme, as required in law; the variable state of the scheme’s records and the time taken to agree entitlements with NICO; where an employer was insolvent, the inability of independent trustees to secure a portion of the assets owed as the scheme was an unsecured creditor; delays on both sides in the reconciliation process; and the complexity of pensions law.

2.114. The trustees all recognised that these factors had contributed to the position for many years.

Other matters
2.115. The independent trustees made a number of other points of relevance to my investigation, not covered above. These included:

(i) that the pensions system, especially in relation to the involvement of public and regulatory bodies, was insufficiently ‘joined-up’ and that as a result many issues were not approached in a consistent and effective manner;

(ii) that words like ‘guaranteed’ should never have been used in relation to pensions or any other form of investment activity – and that the limits to the security of final salary schemes had been obscured by the regular use of such language by Government and others in the past;

(iii) that many scheme administrators had used official publications as the basis for their practice manuals and other scheme documentation and, while there was a duty to seek advice, many administrators saw public bodies as a source of information and advice at least as authoritative as either their lawyers or actuaries;

(iv) that it was not clear that the Government had learnt from the lessons of the past in ensuring that the limitations of the protection afforded by the new PPF are being made clear to scheme members and the general public;

(v) that it was not clear how the amount provided to fund the FAS could deliver anything other than minimal support or support to only a few – and that many of the potential recipients of ‘assistance’ from the FAS were extremely upset by the terminology used and the amount of money available;

(vi) that the changes over time to the MFR did not appear to have been consistent with the public’s perceptions of those changes, as they had not strengthened the MFR test but indeed had weakened it;

(vii) that the removal of Advance Corporation Tax relief had not only cost the pension schemes significant amounts of money, but had also invalidated the rationale behind the MFR (which in part led to the subsequent changes to it);

(viii) that there remained a fundamental tension between the need to ensure that employers were not dissuaded from starting or continuing to sponsor schemes and the increased costs of ensuring that a reasonable level of security was provided to scheme members – and that in the past Government
initiatives had tended to portray moves to relieve the burden on employers as being a means of strengthening member protection. This had often been misunderstood;

(ix) that it had never been clear to many in the pensions industry whether the Government or the actuarial profession were responsible for the MFR; and

(x) that – even with the advent of the PPF – a programme of education is still necessary to underline the fact that employers provide pensions on a voluntary basis and that any occupational final salary scheme is only as secure as the employer standing behind it.

Observations by the FSA

3.116. The Chairman of the FSA told me that he did not agree with the view expressed by the independent trustees we had interviewed that the term ‘guaranteed’ should not be used, or only used with a clear qualification, in circumstances where the insolvency of the giver of the guarantee would result in the beneficiary not receiving all the benefits to which they were entitled. He said that ‘guaranteed’ did and does have a lay meaning – namely, that the consumer is being told what return they can expect when a financial product pays out on maturity in normal circumstances.

3.117. The Chairman said that the FSA has for a number of years had rules governing how financial products are promoted. Subject to the promotion overall being ‘clear, fair and not misleading’, those rules allow banks and life insurance companies to describe, in the case of the former, deposits as having a ‘guaranteed’ rate of return and, in the case of the latter, a policy (including a pension) as having ‘guaranteed’ benefits. In neither case does the FSA regard the consumer as being given a promise about the continued solvency of the firm providing the product. In the context of the schemes with which my investigation is concerned, the FSA has noted that it used the word ‘guarantee’ as a simple way of distinguishing between personal pensions, where the consumer bears the investment risk, and defined benefit occupational pension schemes, where the member is able to predict the level of benefit he could expect to receive on retirement and so it is the employer which bears the investment risk.

3.118. The Chairman told me that he considered that there were good reasons for this. He said that, in almost any financial transaction, a promise is only as good as the soundness of the giver of that promise. It would not help a consumer if every piece of material promoting a product were covered by a solvency warning – over-use would blunt such a warning or would cause unjustified concern and confusion. This was of equal relevance to final salary schemes, where the use of the term ‘guaranteed’ was not used by the FSA to indicate the continued solvency of the sponsoring employer of a scheme or the indefinite continuation of the scheme itself.

Actuarial advice

3.119. In order to assist me to investigate whether the decisions – both to change the actuarial basis of the MFR calculation and also not to subsequently warn members that these changes had allegedly had the effect of weakening the protection afforded by the MFR to their accrued pension rights – were taken with maladministration, I sought independent actuarial advice.

3.120. The focus of that advice was on whether the 1998 and 2002 changes to the formula underpinning the MFR were significant; and, if so, whether they implied or involved a reduction in the protection offered to scheme members.
3.121. I now turn to consider the advice I have received. What follows is necessarily only an outline of that advice.

The design of the MFR

3.122. My advisers tell me that the original design of the MFR had a number of limitations in terms of its ability to keep pace with market conditions and thus to maintain the level of protection it was intended to provide to members of final salary schemes.

3.123. I am advised that these conditions include:

- that the UK was moving into an era of historically low inflation and low real interest rates (as evidenced by the fall in fixed interest gilt yields);
- the removal by Government, in the July 1997 Budget, of the ability of UK pension schemes to reclaim the tax credit deducted from UK dividends. There was, however, at the same time an offsetting reduction in UK corporation tax from 33% to 31%. I am advised that the aggregate impact was nevertheless an immediate step reduction in income for UK pension funds;
- indications that companies were finding different ways of returning value to shareholders, for example through share buy backs, and that fundamental changes in the commercial environment were causing dividend yields to fall;
- in the late 1990s, the market values of UK equities were at an all-time high and rising – the so-called ‘technology bubble’ in equity prices; and
- the one-off effects of large scale acquisitions and disposals by companies included in the FTSE Actuaries All-Share Index, which had distorted the yield on the index as a whole.

3.124. In addition to these contextual factors, my advisers also tell me that the non-pensioner MFR basis often placed a lower value on pension benefits than the pensioner MFR basis.

3.125. Taking these factors together, I am advised that the non-pensioner MFR basis had been weakened since its inception by the market effects highlighted above, such that the chance of an MFR transfer value being sufficient to provide the member’s pension, as measured on the MFR pensioner basis, was significantly reduced even without the changes to the MFR basis, which were made in 1998 and 2002.

3.126. Moreover, the long-term assumptions for the non-pensioner MFR basis did not take into account the falling gilt yields over the period.

3.127. I am also advised that the MFR pensioner basis did not keep pace with the cost of securing pensions by purchasing annuities because of improvements in life expectancy and the strengthening of other factors in annuity pricing bases.

3.128. These factors led to the MFR being seen as unsatisfactory as the statutory basis for scheme funding and in need of replacement.

Changes to the MFR

3.129. The changes made to the MFR basis in 1998 and 2002 were principally two changes to the equity market value adjustment. As a result, the changes did not affect the MFR liabilities for pensions already in payment and only partially affected those of non-pensioners within ten years of MFR pension age.

3.130. The full effect of the changes was only felt by non-pensioners more than ten years under MFR pension age, because the MFR effectively assumed that a member taking a transfer value from a scheme would invest it in full in UK equities until they were ten years from MFR
retirement age. At this point, they were assumed to gradually switch it all into long dated gilts.

3.131. I am advised that, in practice, members taking transfer values to personal pension vehicles have a wide range of investment options and often invest much more conservatively than assumed in the MFR basis. This would typically have reduced the probability of MFR transfer values being sufficient to provide the deferred benefits given up. However, what follows is based on the assumptions underlying the MFR basis as it stood throughout the relevant period in question.

**First change**

3.132. With effect from 15 June 1998, the equity market value adjustment changed from being calculated as the ratio of 4.25 to the gross dividend yield on the FTSE Actuaries All-Share Index to the ratio of 3.25 to the net dividend yield on the FTSE Actuaries All-Share Index.

3.133. My advisers tell me that the reason for the change from a formula based on the gross yield to one based on the net yield was that, with effect from 2 July 1997, tax credits for pension schemes on UK company dividends were abolished.

3.134. They advise me, however, that the reasoning for the change from a formula based on the gross yield to one based on the net yield was that, with effect from 2 July 1997, tax credits for pension schemes on UK company dividends were abolished.

**Additional minor change**

3.135. With effect from 1 June 1999, changes to the FTSE Actuaries gilt indices also made a minor technical change to the gilt index to be used in the calculation of the gilt market value adjustment. I am advised that this is not of significance to the issues I have investigated.

**Second change**

3.136. With effect from 7 March 2002, the equity market value adjustment became the ratio of 3.00 to the actual dividend yield on the FTSE Actuaries All-Share Index. I am advised that the stated rationale for this change was set out in a letter from the actuarial profession to DWP on 5 September 2001.

3.137. The transitional period of the MFR had been due to end on 5 April 2002, at which point the maximum period within which any MFR deficit had to be eliminated was to have become five years.

3.138. At the same time, the Government proposed — and Parliament approved — an amendment to the relevant Regulations so that, with effect from 19 March 2002, where an actuary certified a schedule of contributions following an MFR valuation and the MFR funding level was less than 100%, the period for correcting the deficit was extended to a maximum of ten years.

3.139. Furthermore, at the same time, the period to eliminate serious shortfalls, defined as the deficit when the MFR funding level was less than 90%, was extended to three years by parallel changes to the relevant Regulations. This period was due to have become one year from 6 April 2002.

**The significance of the changes on MFR calculations**

3.140. My advisers analysed MFR liabilities for non-pensioners aged between 20 and an assumed MFR pension age of 65 — calculated in March 2002 on three bases: using the original 1997 formula; that in operation after the June 1998 change to the formula; and also that in operation after the March 2002 change.
3.141. They advise me that the 15 June 1998 change reduced the value of MFR liabilities for members more than ten years away from their MFR pension age by 9.4%.

3.142. I am also advised that the 7 March 2002 change to the formula reduced the value of MFR liabilities for members more than ten years away from their MFR pension age by 7.7%.

3.143. Thus, the effect of the combined changes, compared to the original 1997 basis, was a weakening in the MFR basis of approximately 17%, although this could only be an approximation because, by the time of the later change, the gross dividend yield had ceased to be published.

3.144. My advisers also undertook calculations using their stochastic model (see annex B) to assess whether the MFR provided to members a ‘reasonable expectation’ of achieving equivalent benefits through a personal pension both before and after the changes to the MFR basis. This was done by generating sets of possible outcomes at January 1996, April 1997, June 1998 and March 2002 according to the basis set out in annex B. The probabilities are shown in the table below.

3.145. The Government’s intention was that non-pensioners should have at least a 50% chance of receiving their full pensions if their scheme was fully funded to the MFR level. The two changes to the MFR calculation on this analysis reduced the probability of meeting that original intention by between 6% and 9% at ages up to 45. At age 55, by which time the member is only ten years from retirement, the reduction was considerably larger.

3.146. Consequently, after the March 2002 change, I am advised that MFR transfer values only had just above a 35% chance (at ages up to 45) of providing the member’s pension.

3.147. As I have said above, this analysis does not reflect the further falls in probabilities that would be seen if improvements in life expectancy and other loadings in annuity terms (which my advisers estimate could have reduced the probabilities to less than 30%) or the significantly reduced probabilities for underfunded schemes were also taken into account.

3.148. The advice to me is that both changes to the MFR basis resulted in a significant reduction in the liabilities which any scheme was deemed to have and, assuming no additional funding was forthcoming, a scheme’s disclosed funding position against the MFR level improved across the board.

Protection afforded by MFR and the policy rationale

3.149. What of the protection afforded to pension scheme members and their accrued rights by the MFR?

<table>
<thead>
<tr>
<th>Probability of sufficient assets to provide accrued pension</th>
<th>Before equity MVA changes</th>
<th>After equity MVA changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date</td>
<td>Age 25</td>
<td>Age 35</td>
</tr>
<tr>
<td>January 1996</td>
<td>50%</td>
<td>51%</td>
</tr>
<tr>
<td>April 1997</td>
<td>51%</td>
<td>52%</td>
</tr>
<tr>
<td>June 1998</td>
<td>47%</td>
<td>50%</td>
</tr>
<tr>
<td>March 2002</td>
<td>43%</td>
<td>44%</td>
</tr>
</tbody>
</table>
3.150. My advisers tell me that the weakening of the MFR basis through the changes to the equity market value adjustment outlined above accounted for about half of the reduction in protection from the original policy intention, with the rest being in consequence of the changed economic and policy context.

3.151. They also tell me that such changes went in the wrong direction if the intention had been to rectify an already weakened MFR and return it to its original strength. Instead the changes relied on an assumption that more of the return to pension schemes would come from capital growth, instead of dividend income, than had been the case historically.

3.152. I am advised that the 2002 change to the equity market value adjustment was the only one of the three earlier proposals for interim reform of the MFR proposed by the actuarial profession in May 2000 that would have had the effect of weakening the MFR.

3.153. In their response to my enquiries on this matter, DWP has stated that the intended effect of both the 1998 and 2002 changes was to realign the MFR more closely with the strength that was originally intended. In support of this assertion, DWP noted that, regarding the 1998 change, the Institute and Faculty of Actuaries had said that it was required because changes had called into question the continuing consistency of the MFR basis with the Government’s original intentions and, regarding the 2002 change, that it was stated in a letter sent on behalf of the actuarial profession to DWP in September 2001, that the further change to the MFR was aimed at bringing its strength back to that originally intended. That is, that developing economic trends had caused the MFR to operate at a stronger level than originally intended and that a weakening of it would realign it with its original strength.

3.154. DWP also told me that these changes were recommended to Ministers in the light of the actuarial profession’s advice, and after seeking independent confirmation from GAD that what the profession was proposing was reasonable in the circumstances; that the changes were welcomed publicly by the actuarial profession (in a press release of June 1998, the Faculty and Institute of Actuaries welcomed the changes because they ‘correct a distortion in the results which was causing increasing concern to employers and their advisors’); and that no concerns about the actuarial effect of the changes were drawn to DWP’s attention at or after the time the changes were promulgated.

3.155. However, I am advised that it is impossible to reconcile these submissions about the effects of the changes to the MFR basis with the original policy intention behind the MFR.

3.156. This is because the MFR had, by the time of the changes, already been weakened from its original level; and the effects of the changes implemented by the Government involved a significant further weakening (on top of the 1998 change) of the protection afforded to scheme members by measurement against funding levels on an MFR basis.

Comments of actuarial profession

3.157. I asked the governing bodies of the actuarial profession to comment on the advice I had received, which is set out above. I received their comments on 13 January 2006.

3.158. The profession stressed that it was ‘not criticising the work carried out by [my] actuarial adviser’ but rather they felt that ‘those of us who were involved in recommending the changes in MFR to the Government can contribute additional insights to assist in a fuller understanding of the circumstances’.

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3.159. Without setting out some ‘legitimate wider considerations that were important at the time’, the profession thought that the analysis and conclusions set out above would fail to provide a sufficiently balanced view of what was a very complex matter.

3.160. The profession then set out such considerations in relation to both the 1998 and 2002 changes to the MFR basis.

1998 change
3.161. The profession told me that, immediately prior to the June 1998 change to the MFR, the equity market value adjustment (MVA) had risen to such an extent that some schemes were in danger of breaching the Surplus Regulations and becoming liable to a tax charge. In other words, they said that the minimum funding ‘test’ was causing some schemes to exceed the maximum funding allowed with full tax privileges.

3.162. An even more powerful concern, widely felt by employers, scheme trustees and actuaries at that time, had been that it was possible at most ages for a member of a final salary scheme to take a minimum transfer value, calculated on the MFR basis, and to invest that transfer value in a gilt based personal pension such that they could be virtually 100% certain (subject to future annuity rates) of obtaining a greater pension than they were giving up by taking the transfer value.

3.163. The profession said that this meant that the MFR test had become very much tougher than the Government’s specification of ‘at least an even chance’ of replicating the scheme’s benefits.

3.164. The profession told me that the high equity MVA prior to June 1998 enabled members to be virtually certain of getting better benefits. This supported their contention at the time that the MFR had become tougher than the Government had originally intended. Consequently, the profession’s recommendation in May 1998 that the Government agree to change the equity MVA was aimed at returning the MFR to the strength Government had originally intended it should be.

2002 change
3.165. In relation to the 2002 change to the equity MVA, the profession told me that this had been driven by a need to reflect changes in companies’ behaviour in relation to buying back shares as an alternative to the payment of conventional dividends.

3.166. The profession said that at the time there had also been strong criticisms of the arbitrary nature of the MFR formula, such as evidenced by the impact of corporate activity, which the profession had referred to in its May 2000 report of its review of the MFR for Government.

3.167. The profession told me that contemporary analysis had shown that a scheme which had been 100% funded on the MFR basis immediately after the June 1998 change to the equity MVA and which had adopted a ‘neutral’ passive investment strategy would have become less than 90% funded over a period of less than two years. In other words, the profession said that this demonstrated that the MFR had been becoming a progressively tougher test than had been originally intended and that action was required to return it to its original strength.

3.168. It was in this context that the profession’s recommendation had been made. Moreover, the recommended adjustment had been more complicated than it had appeared on the surface, as it was made to reflect two competing trends – improved mortality and a higher than intended equity MVA – which would in addition have a differential impact on individual schemes. This had been explained clearly in their letter of 5 September 2001 to DWP in which their recommendation had been made.
Further comments  
3.169. In addition to its comments on the two changes to the MFR basis, the profession told me that all final salary pensions regulation in the UK has always been (and still is) a balance between providing security for members’ benefits while not increasing costs to employers by so much that they cease to provide, on a voluntary basis, such pensions for their employees.

3.170. The profession said that it was not possible, at one and the same time, to meet all of the following three conditions:

- investment of pension scheme assets in equities;
- stable employer contributions over time; and
- stable levels of member security over time.

3.171. The profession said that, by way of example, to achieve stable protection of members’ benefits and stable employer contributions, it would be necessary to require schemes to invest all their assets in gilts (assuming insurance company buy-out rates followed gilt prices). Alternatively, if investment was in equities, then in order to achieve stable protection of members’ benefits, it would be necessary to require companies to pay additional contributions whenever the equity market fell relative to the gilts market.

3.172. The profession told me that, given those imperatives, it was not surprising that the level of member security provided by the MFR was volatile. They said that this had been known by Government at the time of the March 2002 change to the MFR basis, as it had been clearly illustrated in the profession’s May 2000 report on their review of the MFR that DWP’s predecessor had commissioned.

3.173. The profession said that ‘therefore, decisions about reacting to short term changes in the level of protection afforded by the MFR test were far from straightforward, given the desire, from the employers’ and ultimately the members’ perspective, for a stable environment for planning employers’ financial obligations to their schemes’.

My assessment  
3.174. I am grateful to the actuarial profession for their comments, which gave me useful insight into the context in which their recommendations in May 1998 and in September 2001 were made. I would make two further observations on their comments.

3.175. My first observation is that I do not doubt that the other contextual factors to which the profession drew my attention – including the need to consider the interests of employers by not increasing costs – might have been important considerations for the profession or for Government at the time.

3.176. However, my concern in seeking actuarial advice on the economic and demographic context in which the DWP’s decisions to amend the MFR basis in 1998 and 2002 were taken was limited to consideration of whether the MFR at the relevant times met the original policy intention that Government had set for the MFR.

3.177. In response to the complaints made about those decisions, the Government said that the rationale for agreeing to amend the MFR basis on both occasions was that the changes would realign the strength of the MFR with its original policy intention. While there may well have been other concerns of which the decision-makers within DWP might have been aware, the evidence set out in chapter 4 of my report makes it clear that the stated rationale for their decision on both occasions was realignment with this policy intention.

3.178. Thus, the advice I have received was properly restricted to an assessment of whether
the MFR was, at the relevant times, able to
deliver an even chance for non-pensioners that
they would receive their pensions following
investment of the transfer value provided. I am
satisfied that the advice I have received on this
question is robust.

3.179. Secondly, while many of the broader
comments made by the profession have been
echoed by my advisers, they have advised me
that some of the observations made by the
profession are surprising.

3.180. My advisers tell me that the Surplus
Regulations did not make a significant
contribution to a position in which schemes
became ‘under-funded’ on the MFR basis. My
advisers tell me that it can be shown that, even
allowing for quite different scheme profiles,
MFR funding levels would have to have been
well in excess of 150% to run the risk of
breaching the Surplus Regulations at the time
of the 1998 change. I have seen no evidence
whatsoever that any of the schemes whose
members have complained to me were ever
funded to such levels.

3.181. Moreover, I do not see how the minimum
funding requirement for all schemes – and thus
the protection of all scheme members’ pensions
– could be weakened merely because some
schemes were very well funded. Sponsoring
employers of such schemes were allowed to take
‘contribution holidays’. I therefore do not
understand the suggestion that there was no
alternative to weakening the MFR test for all
schemes because of the position of the best
funded schemes.

3.182. In any case, even if concerns about the
effects of the Surplus Regulations were part of
the context in which the MFR changes were
made, these concerns formed no part of the
stated reasons given by DWP for making those
changes. The same is true for any concerns that,
when the 1998 change was made, it was possible
at most ages for a member of a scheme who was
provided with a transfer value to invest it in a gilt
based personal pension so that they could be
virtually 100% certain of obtaining a greater
pension than that given up by taking the transfer
value.

3.183. In considering complaints about the
decisions in both 1998 and 2002 to amend the
MFR basis, I will assess those decisions having
regard both to the reasons given by the decision-
makers at the time – alignment with an intention
that would enable non-pensioners to have an
even chance of receiving their pensions following
investment of a cash equivalent transfer value –
and to the way in which those decisions were
taken.

3.184. Having set out the enquiries I made during
my investigation, I now turn to set out the results
of my scrutiny of various documentary sources
of evidence relevant to the complaints I have
investigated.
4. The documentary evidence

Introduction
4.1. This chapter sets out the evidence that my investigation has uncovered through consideration of departmental files, official publications, and other documentary sources.

The Maxwell affair
4.2. In December 1991, after the death of Robert Maxwell, a shortfall of £450 million came to light in the Maxwell companies' pension schemes. It was discovered that, as a result of missing funds – which became the subject of subsequent litigation – the schemes were not able to meet in full their financial commitments. This included being unable to meet their liabilities to pay out employees' pensions or to enable non-pensioners to transfer their accrued pension rights to another pension scheme or other approved savings facility.

The Pensions Law Review Committee
4.3. In the light of the issues raised by the collapse of the Maxwell business empire and the significant shortfall in its associated pension schemes, the then Secretary of State for Social Security, Peter Lilley, put in place a rescue package for the Maxwell pension funds.

4.4. In June 1992, he also asked Professor Roy Goode to chair a committee of inquiry, whose terms of reference were:

To review the framework of law and regulation within which occupational pension schemes operate, taking into account the rights and interests of scheme members, pensioners and employers; to consider in particular the status and ownership of occupational pension funds and the accountability and roles of trustees, fund managers, auditors, and pension scheme advisers; and to make recommendations.

4.5. The Pension Law Review Committee (PLRC), to give the committee its full title, reported on 30 September 1993.

4.6. The Goode Report – ‘Pension Law Reform’ – provided a critique of then existing pension law. The view of the PLRC was that such law was considerably complex but lacked structure and organisation. The law also allowed such wide powers and discretion to be left in the hands of the sponsoring employer and the scheme trustees that the interests of scheme members were not always sufficiently protected. In the Committee's view, there was also an undesirable absence of a compensation scheme when things went wrong, in contrast to the position in relation to other investment activity, and there was no regulatory body with the jurisdiction and powers to monitor and enforce proper standards in the administration of occupational pension schemes.

4.7. The Report contained 218 specific recommendations, but, by way of summary, set out six 'key recommendations', namely:

(i) that Trust law should continue to provide the foundation for interests, rights and duties arising in connection with occupational pension schemes but should be reinforced by a Pensions Act administered by a pensions regulator;

(ii) that the freedom of action trustees had should be limited so as to ensure the reality of the pensions promise, to protect rights accrued in respect of past service, and to allow members to make appointments to the trustee board;

(iii) that the provision of information to members by their pension scheme should be improved both in content and in clarity and presentation;

(iv) that the security of members' entitlements should be strengthened by minimum solvency requirements and by monitoring both by a pensions regulator and by scheme
auditors and actuaries, coupled with restrictions on withdrawals by employers of surplus funds from schemes where such existed and also, as a last resort, the establishment of a compensation scheme to cover deficits arising from fraud, theft or other misappropriations;

(v) that, on establishing a scheme, the sponsoring employer should be free to reserve the right to close, freeze or wind up their scheme, to approve or to refuse increases in benefit and to reduce or to stop contributions, subject to the minimum solvency requirements; and

(vi) that the administrative burdens on employers and scheme administrators should be reduced wherever possible, and flexibility increased, through simplification of the relevant law and its administration.

The Government’s response

4.8. The Pension Schemes Act 1993 received Royal Assent on 5 November 1993. It consolidated the existing law relating to pensions schemes with the aim of making that law more transparent and better understood.


4.10. The White Paper set out the Government’s proposals, on which views were sought, to implement the key recommendations of the Goode Report that it was inclined to accept.

4.11. In relation to the security of pension scheme members’ accrued rights, the White Paper proposed that a minimum solvency requirement would be introduced for defined benefit schemes. It went on:

The Government agrees with the PLRC proposals that a minimum solvency requirement should be introduced. This is not only to reinforce confidence that accrued rights will be protected but also to provide a basis and yardstick for setting a schedule of contributions to maintain an appropriate funding level – thus providing a key measure for trustees in maintaining and managing the scheme and for giving clear information to members on the health of the scheme...

4.12. The White Paper went on to describe which schemes would be subject to the solvency requirement, how minimum solvency would be calculated, the transitional arrangements for its phasing in, mechanisms for regular ‘health checks’ on each scheme, and the relationship between the solvency requirement and the indexation provisions set out elsewhere in the Government’s proposals.

4.13. Following a consultation process, these proposals formed the basis for a Pensions Bill.

Further discussions on detailed legislative proposals

4.14. On 11 October 1994, while the consultation process and preparations for the introduction of the Bill were undertaken, the chairman of the Pensions Board of the actuarial profession wrote to DSS concerning the basis of calculation for the proposed Minimum Solvency Requirement (MSR).

4.15. The letter specifically discussed proposals to introduce an equity element for pension liabilities in the case of large pension funds. This followed earlier discussions about a letter from DSS on 26 September 1994, which had set out the Government’s thinking in suggesting this.
4.16. After setting out the profession’s views on the impact of these proposals, the letter ended:

I explained that the views we discussed were provisional ones and that I would seek input from other members of the Pensions Board. The ideas have since been discussed in the Current Issues Committee, and generally supported, as long as it is clear that responsibility for the basis is accepted by the Government – i.e. the introduction of an equity element will increase the probability to some extent of schemes being unable to deliver the winding up liabilities and it is for the Government to decide where to strike the balance between security for the members and financial consequences for scheme sponsors.

4.17. The then Secretary of State for Social Security, Peter Lilley, wrote to Sir John Butterfill MP (as he is now) on 8 December 1994. Publication of this letter was the then Government’s chosen mechanism for publicising the changes to the basis for the proposed solvency requirement that had been agreed by it.

4.18. The letter said that ‘on the basis of further detailed analysis, and in response to comments made on the proposals set out in the White Paper, the Government has decided to... authorise a basis for calculating statutory minimum solvency which would allow the larger defined benefit occupational schemes to value a proportion of their pensioner liabilities by reference to equity returns’. It also set out other changes – to the proposed time limits for restoring scheme funding levels to the statutory minimum level and to enable the calculation of the statutory minimum solvency requirement to be based on market values over a period of months.

4.19. Mr Lilley continued (with original emphasis):

The basic rationale for a minimum solvency requirement is clear and is set out forcibly in the report of the Pension Law Review Committee. In the modern world, no employee can make the comfortable assumption that his employer will be around 20, 40, 60 years hence to pay pension benefits as they fall due. If an employer makes a defined benefit pension promise, the pension fund should therefore be adequate to secure that promise, irrespective of what may happen to the employer over the period before the final pension payment is made.

4.20. The letter continued:

The proposed statutory minimum solvency requirement will provide an important, objective measure of the adequacy of a pension fund; something which members and trustees will be able to monitor and against which the performance of the fund and other important matters can be measured.

4.21. After setting out the rationale for the introduction of an equity element, which it was said would have the effect of ‘not weakening the security of members to any significant extent’, the letter then stated that ‘this adjusted package of measures should ensure that the statutory MSR will deliver an appropriate level of security for members, without imposing unnecessary burdens on business’.

4.22. The letter then set out ‘solid gains in security from the introduction of an MSR’ for scheme members. These included the following:

(i) that there would be ‘a consistent basis for measuring the adequacy of a fund in terms of its ability to deliver at least the cash equivalent of its members accrued rights’; and

(ii) that ‘the valuation basis should ensure that schemes have sufficient assets either to buy out their pension liabilities with annuity contracts or to deliver pension benefits as they fall due, and to pay a fair transfer value to non-pensioner members in respect of their
4.23. The letter, while noting that this would involve additional costs to schemes, stated that such a ‘price is worth paying to produce greater confidence that defined benefit promises will actually be met at the end of the day’.

4.24. On the same day as what became known as ‘the Butterfill letter’ was published, the actuarial profession issued a press statement about its contents. While welcoming the Government’s decisions as to the basis for the proposed minimum solvency requirement, the profession said that it was:

...concerned that the significance of the word “solvency” in describing the proposed test for very large schemes could give a false impression of the winding up position to ordinary members. We therefore see the need for a major effort by Government and those involved in pension provision to educate members of schemes as to the extent of the security for their benefits which the Minimum Solvency Requirement can be expected to provide.

4.25. On 20 January 1995, the actuarial profession wrote to the Secretary of State to express its view that ‘the term solvency was an inappropriate description of the test and was likely to mislead scheme members and others into believing that their benefits would be fully secure if their pension scheme wound up’. The profession suggested that a more appropriate term for the Government’s proposed scheme funding standard was a ‘Minimum Funding Requirement’.

4.26. On 15 February 1995, Mr Lilley replied to the actuarial profession. After setting out the background to the Government’s thinking, he said ‘as to the term “minimum solvency requirement” it could be argued that if minimum solvency is taken to be an absolute guarantee of solvency at all times then it could never be achieved’. He continued by saying that ‘the MSR calculation proposed by the PLRC already accepted the necessity of using the cash equivalent approach in respect of non-pensioner liabilities – which I believe is reasonable and realistic, but which we have to accept is not a guarantee’. He concluded by saying that he believed that ‘it is important how the MSR is explained to members – but whether or not public perceptions might change by using a different name is perhaps debatable’.

4.27 On 20 March 1995, the actuarial profession wrote to DSS officials to express its concern about the clarity of the intention behind some of the legislative proposals then being discussed in Parliament. After discussion of other matters, the profession said that it was ‘very concerned at the misleading impression that a signed minimum funding certificate may give to ordinary scheme members’.

Second Reading of the Pensions Bill in the Lords

4.28. In the meantime, and following its introduction into the Lords, that House gave the resulting Pensions Bill a Second Reading after a debate on 24 January 1995.

4.29. The late Lord Mackay of Ardbrecknish, then the Minister of State at the Department of Social Security, in moving the Second Reading said that:

There are four major principles underlying this legislation. First, confidence in the security of occupational pension schemes was undermined by the Maxwell affair and we intend to restore that confidence by improving security. Secondly, equal pension rights for men and women are required by the European Court of Justice rulings. The Bill will bring domestic legislation into line with European law and will make it easier for
contracted-out salary schemes to equalise benefits for men and women in the future. Thirdly, in order to ensure a fair and sustainable basis for state pensions in the next century, we intend to phase in equalisation of state pension age at 65. Finally, we are committed to making personal pensions attractive across a broader age range, introducing age-related rebates for those investing in personal and money purchase pension schemes.

4.30. In setting out the purpose of the provisions of the Bill related to improving the security of occupational pension schemes, the Minister continued:

Pensions are for many people the most significant single investment they will ever make. They must be confident that the pensions promise of today will indeed be matched by the pension of tomorrow.

4.31. After setting out the specific proposals that were contained in the Bill to deliver this objective, the Minister continued:

No system can offer a total guarantee against fraud. However, we will do everything possible to eliminate the likelihood of fraud or other wrongdoing by strengthening the framework of pension provision.

4.32. In addition to proposals to give scheme members rights to clear and relevant information, to nominate trustees, and to have access to a dispute resolution mechanism for any complaints, the Minister then described the Bill’s provisions insofar as they related to the roles of scheme trustees and of their professional advisors – principally actuaries and auditors.

4.33. In relation to proposals for a statutory minimum solvency requirement to ‘underpin the employer’s pension promise’, he said:

This requirement will reinforce trustees’ and employers’ responsibility for ensuring that schemes are properly funded, thus enhancing security for scheme members. This will provide an objective benchmark for assessing the adequacy of the fund, setting contribution levels and monitoring the fund’s performance. It will act as a mechanism for ensuring that schemes have adequate funds to meet contracted-out benefits. Finally, it will provide the measure against which the amount of compensation will be calculated when a successful claim for compensation is made.

We have consulted widely on how such a requirement should be defined in order to balance the concerns of employers... against improving security for scheme members. We believe that we have struck the right balance to give scheme members the security they must have if occupational pensions are to prosper and to encourage employers to run good schemes.

4.34. In the debate, in addition to consideration of the other measures proposed in the Bill, criticism was levelled at the proposed solvency standard as not being consistent with the recommendations of the Goode report and as constituting a ‘watering down’ of the measures on which the Government had consulted through its White Paper. It was also suggested that the name proposed for the requirement was misleading, as the requirement related to scheme funding rather than constituting a solvency test.

4.35. In summing-up and responding to the debate on the proposed measures for increased security, Lord Mackay said:

Our concern has been to devise a consistent basis for valuing scheme liabilities as a measure of the adequacy of pension funds to meet their liabilities, and as a basis for assessing matters such as minimum contributions. In considering what should be the appropriate valuation basis, we have borne in mind the need to define an appropriate level of security for members’
pensions, and for an entitlement, without actually imposing unnecessarily high costs on employers, which might have led to a significant reduction in the level of occupational pension provision.

**Consideration of the Bill by the Lords in Committee**

4.36. Following approval of the Bill on Second Reading, the House of Lords resolved itself into Committee on 7 February 1995 to consider the Bill in detail.

4.37. In discussion about the proposed minimum solvency requirement and, specifically, in relation to the then Opposition's attempts to amend the Bill to provide for a minimum contribution requirement instead, Lord Mackay said:

*I am convinced that a measure of solvency that does not address the position of the scheme on discontinuance in some way will not be providing members with adequate security in the event of the scheme being wound up.*

The overwhelming argument in favour of a minimum solvency requirement is that if an employer undertakes to provide a pension promise the scheme should be able to secure that promise at all times, especially in the event of a scheme winding up. It is at that time that the members’ position is most vulnerable. A minimum solvency requirement should ensure that, irrespective of what happens to the sponsoring employer, the fund will have enough money to meet the value of members’ accrued rights which will therefore be protected.

But security has a price... 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 the liabilities with non-profit annuities. For many schemes the cost would be prohibitive...

We are introducing a new power to enable trustees to secure benefits on wind-up by providing members with a cash value of accrued rights. Where a scheme is only funded at the level of [the] minimum solvency requirement, the calculation for this will be that used for calculating liabilities for the minimum solvency requirement.

4.38. In asking the Committee to reject the Opposition amendments and to support the Government’s proposal, the Minister said:

*We believe that our provisions, together with the proper operation of the minimum solvency requirement, will substantially reduce the likelihood of schemes winding-up in deficit.*

4.39. A central discontinuance fund, which would provide support to members of schemes which could not meet their liabilities in full, was not in his view necessary and, moreover:

...there would be a real temptation for schemes to sail close to the wire... because they would know that they had a back-up if they wobbled on to the wrong side. I remind the Committee that there is a pension promise to each scheme. There is a promise with regard to the contributors and a promise for when members of the scheme become pensioners.

**Consideration of the Bill at Report Stage in the Lords**

4.40. Consideration of the relevant provisions of the Bill continued on 13 March 1995, when the House of Lords considered the Report of the Committee. During this debate, Opposition members continued to press for an ongoing funding requirement in contrast to the Government’s proposal.
4.41. Lord Mackay, in countering the Opposition’s arguments, said:

During Committee, I said that the central weakness of an ongoing funding requirement is that it does not aim to provide any level of protection in the event of a scheme winding-up. I know that some noble Lords may want to argue that the bulk of employers do not become insolvent and that it is therefore unreasonable to require schemes, at all times, to have sufficient assets to meet their accrued liabilities. I do not accept that argument. On the contrary, I believe that scheme members have the right to a clearly defined measure of protection...

Members who have had their benefits reduced on a wind-up are unlikely to take much comfort from the fact that they would have been secure had their employer remained in business. To put it another way, it is quite unacceptable that employers should be able to continue trading at the risk of leaving their employees’ legitimate pension expectations unfulfilled.

4.42. The Minister went on to ‘repeat the merits of the minimum funding approach and what it is intended to deliver’:

It will require schemes to hold sufficient assets to be able to secure pensions already in payment, either by buying annuities or paying benefits as they fall due, and provide younger members with a sum of money to be invested further. The pensions they eventually draw will obviously depend on how the money is invested and the rates of return on the investment, but there is every chance of it producing a pension at least as good as, and probably better than, that which would be paid from a deferred annuity.

The minimum funding proposals offer a far better measure of security for all members of defined benefit schemes than any alternative affordable proposals...

...we need to respond for scheme members who are unfortunate enough to work for employers who go out of business and are thus unable to stand behind their pension fund. These members could well find that, as the law stands at present, they would receive less than they have a right to expect. We live in the real world where employers do go out of business. We believe that schemes must be funded at a proper level to secure benefit rights if that should happen.

4.43. The Minister then explained why it was now proposed to rename the minimum solvency requirement.

4.44. Lord Mackay explained:

... by changing the name to a ‘minimum funding requirement’, there is not the slightest deviation from what the requirement will do. It will mean that members can be confident that the value of their accrued rights is secure, especially in the event of the scheme or the employer company winding up... true solvency could only mean the ability to buy out all benefits with guaranteed insurance annuities. The PLRC recognised that such a measure of solvency would not be practical and would be unduly costly. The Government fully accepted this... It is only right that the members’ investment, and their accrued pension rights, should be properly protected. Our proposals are designed to provide that protection. As suggested by the PLRC Report, we had called the vehicle for providing that protection a ‘minimum solvency requirement’. The change of name in no way reduces what the requirement is intended to achieve.

Third Reading debate in the House of Lords

4.45. The House of Lords considered the amended version of the Bill in a debate on 21 March 1995. Disagreement continued on what the most appropriate form of funding test would be to provide the best security for members’ accrued pension rights.
4.46. Lord Mackay reiterated the Government’s view that:

...our proposal for an MFR will not increase costs for most schemes. However, what it will do – by contrast to the [Opposition] amendment – is to provide a greater degree of certainty for the members of schemes that the rights they have accrued at any point in time will be adequately secured.

4.47. In response to a proposed amendment to protect the position of the indexation of existing pensioners’ payments in relation to the proposed new order of priority for the discharging of scheme liabilities on wind-up, the Minister said:

The intention is to ensure that when a scheme winds up, all of the members are treated fairly. If the scheme is fully funded to the level of the minimum funding requirement, all of the members should receive the full actuarial value of their accrued rights, including the right to indexation, should the scheme wind up. But there will be circumstances where schemes wind up less than 100 per cent solvent on the statutory minimum funding basis or are otherwise unable to meet their liabilities in full.

Obviously, we hope that schemes will not wind up in a position where they are unable to secure the benefits promised under the scheme. We believe that the minimum funding requirement and the wide range of other measures for enhancing scheme security incorporated in the Bill will minimise the chances of schemes winding up in this position. But we live in the real world, and we must cater for those cases where things go wrong despite our best endeavours.

A scheme which does not meet in full the statutory minimum funding requirement will not be able to meet all of its liabilities on wind up. That is when the priority order will come into play and ensure that there is an equitable distribution of assets. It is only right that pensioners should receive some priority over active members. That is why we propose that they should, if possible, suffer no reduction in their income. That is reflected in the priority order we propose.

However, to go further and give priority to indexation for all pensions in payment would place at risk the rights of other members. We have to ensure that the assets are shared fairly. We believe that this can best be done by protecting pensions in payment first, then protecting the basic pension entitlement of all other scheme members, then sharing out whatever assets remain for the benefit of all scheme members.

Second Reading debate in the House of Commons

4.48. Following transmission of the Bill from the Lords, the House of Commons gave the Bill a Second Reading on 24 April 1995.

4.49. The then Secretary of State for Social Security, Peter Lilley, reiterated the key principles behind the Bill which, he said, together formed ‘lines of defence against fraud and misuse of pension scheme assets’. The MFR was described as the fourth line of defence.

4.50. The then Minister for Social Security and Disabled People, William Hague, in closing the debate for the Government, said:

Governments have to calculate the costs and benefits of their policies. Governments have to arrive at the right balance, which means that we will have strong, funded occupational pension provision in this country, thoroughly regulated without killing the goose that lays the golden eggs. That is what we are setting about in this major piece of legislation. It is the right legislation. It will bring security, equality and choice to pension provision. It deserves the support of the House.
Consideration of the Bill by Commons Committee

4.51. Following approval in principle of the Bill at Second Reading, Standing Committee D of the House of Commons considered the Bill in late May 1995 and in early June 1995.

4.52. During the afternoon session on 23 May 1995, Mr Hague said:

The key principle underlying the minimum funding requirement and cited by the Pensions Law Review Committee to justify the use of a discontinuance based test was, as the committee put it:

“where there is a risk, however, small, of the employer’s insolvency, funding will meet the requirements of benefit security only if at all times the assets of the scheme are sufficient to cover its liabilities”.

4.53. He went on:

The MFR will enable schemes to provide for pensions and for the accrued rights – nothing to do with the expectation of what might be accrued – of their non-pensioner liabilities.

4.54. In dealing with the then Opposition’s support for an alternative solvency standard based on a minimum contributions requirement, Mr Hague said:

The alternative that I advocate is the Minimum Funding Requirement, under which a scheme would have sufficient money on winding up to cover pensions in payment. If it was one hundred per cent funded according to minimum funding requirements, it would have sufficient funds to cover pensions in payment and to give a transfer value – the value of accrued rights – to non-pensioner members.

4.55. Following discussion about the Swan Hunter case, which had then only recently come to light – and specifically about allegations that, even though the Swan Hunter pension scheme would have been fully funded on an MFR basis had that basis been in place at the relevant time, the scheme was now only able to meet approximately 60% of its pensioner liabilities following wind-up and was not able to cover any of its liabilities towards its non-pensioner members – the Minister said:

Schemes funded to the minimum funding requirement will be able to pay every member the cash equivalent of their accrued pension rights, which they would be able to transfer into another pension scheme or into a personal pension.

4.56. When asked by John Denham MP about the position of people very close to retirement who could not transfer to another scheme, who would need to buy an annuity, and who would thus be ‘significantly worse off’, the Minister replied:

People in that position would have their rights valued on a different basis. If they were near to retirement there would be a much larger element of gilt rather than equity valuation to determine the appropriate value for them. These people would receive a larger value, which would be nearer to what would, in many cases, buy an annuity. That cash equivalent for those who are some distance from retirement would be most unlikely to be sufficient to buy an appropriate annuity, but it would be sufficient to transfer into another fund.

4.57. Mr Hague went on to describe 100% funding on an MFR basis as:

...a target which means that if at any stage that scheme winds up, it will be able to keep its pensions in payment and give the cash equivalent of approved rights to the non-pensioner members.
4.58. During further consideration of the Bill on 6 June 1995, the Minister explained again the rationale for the MFR with specific reference to the need to ensure that employer contributions to bring a scheme’s funding up to MFR levels were made within specified time limits. He said:

After everything that has happened in the past few years... we could not be proud of the Bill or of the Act that it will become if we were not in the end able to say that schemes must have sufficient assets available within a certain time to keep pensions in payment and give non-pensioners the value of their accrued rights. Parliament would be in an embarrassing position and would not have done its job. That is the least that we should require of schemes. Without that requirement, what on earth would we say to people who may approach us after the Bill has been enacted and ask whether their pension funds will be able to keep their pensions in payment or give them the value of [their] accrued rights if [the scheme] winds up?

Without the MFR, the answer to such a question would be no. What on earth would we have achieved then?

The Minimum Funding Requirement would mean that the answer would be yes. That is all we seek with the MFR.

**Royal Assent**

4.59. Following consideration of technical amendments suggested by the House of Commons, and approval of the final version by both Houses, the Bill received Royal Assent on 19 July 1995.

**Main effects of the Pensions Act 1995**

4.60. As a result of the enactment of the Pensions Act 1995, many changes were made to the regime governing pension provision in the UK, including in relation to the basic state pension retirement age, to the rules for contracting out of SERPS, and to sex equality within state and non-state pension provision.

4.61. The principal effects of this new legislation that are relevant to this investigation were:

(i) that OPRA was established, with the remit of ensuring that occupational pension schemes complied with pensions law and the Authority’s other directions;

(ii) that the MFR was imposed on most defined benefit occupational schemes not in the public sector, to ensure that a scheme was properly funded;

(iii) that a new statutory priority order for the discharge of pension scheme liabilities was introduced which would over-ride an individual scheme’s rules; and

(iv) that pension scheme members would be able to nominate one-third of their scheme’s board of trustees to represent members’ interests.

4.62. The Act provided that the detailed method of calculation to underpin the MFR would be set out in Regulations (and guidance) to be developed with (and by) the actuarial profession and approved by the Secretary of State – and that these and other provisions of the Act would be commenced at a later date.

**Further discussion between DSS and actuarial profession**

4.63. On 31 October 1995, the actuarial profession wrote to DSS officials to seek a formal statement of the Department’s position on a number of matters, in order to inform the profession’s work on devising the actuarial basis for the MFR.
4.64. DSS replied on 22 November 1995. In relation to the ‘underlying purpose of the MFR’, the DSS official said (with my emphasis):

...that the intention underlying the MFR (which was clearly expressed by Ministers during the passage of the Pensions Bill) is to require schemes to have a level of assets which should as a minimum be sufficient, if the scheme were to wind up, to enable it to pay in respect of each non-pensioner member a sum which if invested in an appropriate alternative pension vehicle could reasonably be expected to generate a pension benefit at least equivalent to that which the scheme would otherwise have paid in respect of rights accrued up to that point in time. By reasonable expectation we mean that there should be at least an even chance.

**Official publicity concerning the Pensions Act 1995**

4.65. In January 1996, DSS published a leaflet — *The 1995 Pensions Act (PEC 3)* — which purported in its 21 pages to be a ‘brief summary’ of the ‘changes to state pensions, occupational pensions and personal pensions’ introduced by the 1995 Act. It said that ‘more detailed information will be published later’. This edition was a revision of an earlier leaflet, published in October 1995.

4.66. The introduction to the leaflet, under a heading ‘why was the Pensions Act needed?’ stated that ‘changes were needed’ as ‘the Government wanted to remove any worries people had about the safety of their occupational (company) pension following the Maxwell affair’.

4.67. Section 3 of the leaflet dealt with ‘changes to occupational and personal pensions’. After explaining the roles of OPRA, the Pensions Ombudsman, the compensation scheme, the Occupational Pensions Board, and trustees, the leaflet, under the heading ‘new minimum funding requirement for salary related schemes’, said:

*The Pensions Act introduced a new rule aimed at making sure that salary related schemes have enough money in them to meet the pension rights of their members. If the money in the scheme is less than this minimum level, the employer will need to put in more money within time limits. The minimum funding requirement is intended to make sure that pensions are protected whatever happens to the employer. If the pension scheme has to wind up, there should be enough assets for pensions in payment to continue, and to provide all younger members with a cash value of their pension rights which can be transferred to another occupational pension scheme or to a personal pension.*

4.68. The leaflet then went on to deal with members’ rights to information from their scheme administrators and trustees, with the Act’s provisions for pensions indexation, with the equalisation of pension rights for men and women, with the position of part-time workers, with new arrangements related to pension transfers and pension sharing on divorce, and with the flexible use of personal pension savings on retirement.

**Announcement of the MFR Regulations**

4.69. On 10 June 1996, Peter Lilley, the then Secretary of State for Social Security, announced that proposals for Regulations to give force to the MFR had been agreed.

4.70. In the press release — entitled ‘new statutory minimum funding requirement gives pension scheme members greater protection’ — that accompanied this announcement, it was said that:

*Schemes funded to this minimum level will be able, in the event of an employer going out of business, to continue paying existing pensions and*
provide younger members with a fair value of their accrued rights which they can transfer to another scheme or to a personal pension.

4.71. The press release then quoted the Secretary of State’s announcement of two changes to the originally proposed MFR basis following ‘extensive consultation’ – in relation to the valuation basis of pensioner liabilities of larger schemes and to the decision not to require the smoothing of MFR calculations.

4.72. He then said:

These two changes will reduce potential costs overall by some £20 million to £30 million a year over the period until the MFR comes fully into effect. They will make the operation of the MFR more straightforward. And they will maintain the level of security provided to members.

4.73. The ‘package’ of proposals being presented in relation to the MFR basis would in the Minister’s view ‘carefully balance concerns about imposing costs on employers whilst achieving member security’.

The MFR and Deficiency Regulations

4.74. The Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 were made by the Secretary of State on 12 June 1996 and were laid before Parliament on 18 June 1996. These Regulations, which prescribed the method of calculation for the MFR that had been agreed with the actuarial profession and also other matters, came into force on 6 April 1997.

4.75. On 11 December 1996, the Secretary of State also made the Occupational Pension Schemes (Deficiency on Winding Up etc.) Regulations 1996. These Regulations prescribed the method of the realisation and discharge of the assets and liabilities of pension schemes on wind-up and also provided for the order of priority in which both would be realised and discharged. They came into force on 19 December 1996.

4.76. On the same day, the Occupational Pension Schemes (Winding Up) Regulations 1996 were made, which came into force on 6 April 1997.

OPRA Chairman’s speech on communication

4.77. On 3 June 1997, the then Chairman of OPRA gave a speech on the ‘communications challenge’ for all those involved in the pensions industry at an awards ceremony for pensions and investment journalists at the House of Commons.

4.78. He argued that the 1995 Act had helped focus attention on occupational pensions and that the roles of trustees, pension professionals, employers and scheme members were ‘now clearly defined’. He went on to say that more needed to be done to stimulate awareness about what individuals needed to do to ensure the best long-term provision for themselves and their families.

4.79. He continued:

Communication for OPRA means getting across important messages to all those involved in workplace pension schemes, including scheme members... Communication for OPRA also involves dialogue with the Government where, in the light of operational experience, the law we enforce may need amendment, update or clarification. Whatever the level of input required, OPRA stands ready to play a full part in the widening debate on the future of retirement provision.

Actuarial Guidance Notes

4.80. On 6 April 1997, a new version (4.0) of the actuarial practice standard guidance note, ‘Retirement Benefit Schemes – Winding-up and Scheme Asset Deficiency’, came into force. In addition, a new guidance note (version 1.0) was issued, entitled ‘Retirement Benefit Schemes – Minimum Funding Requirement’. Both guidance
notes were issued by the Faculty and Institute of Actuaries.

The Office of Fair Trading report
4.81. In early July 1997, the Director-General of Fair Trading published his report of an inquiry into pensions, which had been launched on 19 September 1996, and which had had as its focus the identification of any practices that might adversely affect the economic interests of consumers.

4.82. In relation to defined benefit schemes, the Director-General noted that such pensions:

...have provided and will continue to provide a comprehensive range of benefits which meet many of the needs of consumers. However... long stayers are rewarded at the expense of early leavers. This is implicit in the design of all DB [defined benefit] final salary pension schemes.

4.83. He went on to observe:

Notwithstanding a dramatic improvement in the position of early leavers over the last two decades, losses for early leavers persist. Furthermore, the transfer values that employees receive on leaving DB schemes are subject to a large degree of actuarial discretion that can dramatically reduce their size. The Pensions Act 1995 has had the perverse effect of reducing transfer values for early leavers though it has reduced the scope for variations.

The 1997 Budget
4.84. On 2 July 1997, the Chancellor of the Exchequer made his Budget Statement. In it, he said:

I can confirm also that this Budget will not proceed with the previous Government’s proposal to phase out tax relief on employee pension contributions.

This point in the recovery is, however, the right time to make changes in corporation tax to encourage more long-term investment. My changes in monetary policy were designed to help companies make long-term investment decisions with confidence. The changes in corporation tax are directed to the same long-term objective...

I want the United Kingdom to be the obvious first choice for new investment, so I have decided to cut the main rate of corporation tax by 2 per cent, from 33 per cent to 31 per cent, the lowest ever rate in the United Kingdom.

4.85. He continued:

Too often, British companies have invested too little and too late in the economic cycle... The present system of tax credits encourages companies to pay out dividends rather than reinvest their profits. That cannot be the best way of encouraging investment for the long term, as was acknowledged by the previous Government. Many pension funds are in substantial surplus and at present many companies are enjoying pension holidays, so this is the right time to undertake a long-needed reform. The previous Government cut tax credits paid to funds and companies, so with immediate effect I propose to abolish tax credits paid to pension funds and companies.

Exchanges on the Budget changes in the Lords
4.86. On 10 July 1997, Lord Burnham asked the Government to explain whether they had calculated the consequences of the decisions on advance corporation tax on the MFR and on final salary schemes.

4.87. The then Minister, Baroness Hollis of Heigham, explained the policy rationale for the measure. In response, Lord Burnham asked whether the Government could estimate the number of schemes which would ‘fall into deficit’ as a result of the measure.

4.88. The Minister replied by arguing that ‘about half’ of all schemes were in surplus and were
enjoying a partial or full contributions holiday and then defended the reform.

**The Government's Pensions Review**

4.89. On 17 July 1997, the Government announced a review of pensions and initiated a consultation process with a deadline for responses of 31 October 1997. The terms of reference for the review were:

To review the central areas of insecurity for elderly people including all aspects of the basic pension and its value and second pensions including SERPS; to build a sustainable consensus for the long-term future of pensions; and to publish the Government's proposals, for further consultation, in the first part of 1998.

4.90. In its press release announcing the review, the then Secretary of State was quoted as saying that the review would address 'nine fundamental challenges'. One of these was 'to get the regulation of pensions right... people need to have confidence in pensions and be sure their pensions are secure. We need to find a balance which provides an appropriate level of security, minimises the scope for abuse and does not impose an undue burden on providers'.

4.91. Another challenge was said to be 'to raise awareness of pensions and improve the level of financial education so that people understand the importance of saving for retirement and make the right choice about which pension product is best for them'.

**Revised Actuarial Guidance Notes**

4.92. On 1 March 1998, the actuarial profession issued a revised version (4.1) of their guidance note, 'Retirement Benefit Schemes – Winding-up and Scheme Asset Deficiency' and also a revised version (1.2) of their other guidance note, 'Retirement Benefit Schemes – Minimum Funding Requirement'. These made minor technical changes to professional guidance which are not of relevance to the heads of complaint.

**Parliamentary Questions on the MFR**

4.93. On 9 March 1998, John Denham, the Minister of State for Social Security, replied to a question from Quentin Davies MP which asked what plans there were to alter the minimum funding requirement on pension schemes so as to take into account the lower forecast net dividend yield in consequence of the recent Budget changes.

4.94. His reply was:

The detailed requirement for MFR valuations are set out in regulations and in an actuarial guidance note produced by the Faculty and Institute of Actuaries and approved by the Secretary of State. The Faculty and Institute have set up working groups to look at the effects of the July budget changes on a number of issues, including the MFR, and officials are in close contact with the profession.

Although the Faculty and Institute have made recommendations for changes to the valuation method following the Budget changes, they have now indicated that they wish to do further work on the operation of the MFR generally before revising their guidance note. Any changes must await their further recommendations.

4.95. On 13 March 1998, Nick Gibb MP asked the Minister to explain what assessment had been made of the consequences of the abolition of dividend tax credits for the MFR in the light of a recent report on that issue by a firm of consulting actuaries.

4.96. Mr Denham replied:

It is for the Pensions Board of the Faculty and Institute of Actuaries to make recommendations about any changes to the MFR. They will no doubt take account of [the] views in [the
We expect to receive a report from the Pensions Board when they have completed their consideration of these issues.

4.97. On 8 June 1998, Julian Lewis MP asked the Minister to set out what factors had underlain the decision not to initiate a full review of the MFR immediately after the July budget.

4.98. He replied:

The methodology and actuarial assumptions in the MFR were devised by the Faculty and Institute of Actuaries. We were informed that they would be carrying out a review following the July budget. We fed into that review a report by the Government Actuary, whose views we had sought on a number of issues.

4.99. On the same day, the Minister informed Howard Flight MP that the actuarial profession’s proposals for a change to the valuation method had been agreed and that their guidance note was being revised. He also said that there was an ‘ongoing review of the minimum funding requirement’.

Green Paper on the Welfare State


4.101. The then Minister for Welfare Reform, Frank Field, made a statement in the House to announce the publication of the Green Paper. In relation to the Government’s proposals for pension reform, he said that a key principle underpinning those proposals was that:

...[the] public and private sectors should work in partnership to ensure that, wherever possible, people are insured against foreseeable risks and make provision for their retirement... We want everyone to benefit from a second pension, on top of the state pension. It is clear that, unless there is more saving towards retirement, we will continue to see into the next century far too many of our pensioners retiring on incomes that do not properly reflect the rising prosperity of the nation...

Later in the year, we shall publish the Green Paper on pensions. I can say today that the Government [also] plan to bring forward legislation later in this Parliament.

DSS research report

4.102. In April 1998, DSS published its research report number 75, entitled ‘Experiences of Occupational Pension Scheme Wind-up’.

4.103. The research, which had examined the experiences of members whose scheme had been frozen, wound up or was in the process of winding up, had been commissioned by DSS in January 1996. One of the aims of the research was to ‘find out how much members and beneficiaries know and understand about what has happened to their scheme and to their pension rights’. Another aim was to ‘obtain views on the information scheme members and beneficiaries received’.

4.104. Among the report’s conclusions were findings that:

(i) most members had some understanding about what had happened to their scheme and knew that the scheme was no longer operating in the way it had been. The majority knew that contributions had ceased to the scheme and that it had or would in due course cease to exist. Most also knew the reason for the changed status of their scheme, citing as the most common explanations the insolvency of their
employer, a company take-over, or the sponsoring employer’s decision that the scheme was too expensive to run;

(ii) members were fairly evenly divided between those who had some understanding of what had happened to their pension rights and those who did not. Those who were not aware were said to be associated mostly with schemes which were frozen or those where the winding up process was not well advanced; and

(iii) members were evenly divided between those who thought that the information they had received about their scheme was good and those who thought it was poor. It was said that the latter group felt that they had not received enough information about the process and that such information as they had received had been difficult to understand, lengthy, and full of jargon and unexplained statistics.

4.105. The report did not deal with the awareness of the risks to their pensions that those members that had been interviewed as part of the research had had prior to the change in status of their scheme.

**Actuarial recommendation to amend the MFR**

4.106. The actuarial profession wrote to DSS on 1 May 1998. The letter was headed ‘Minimum Funding Requirement: Effect of Budget Changes’. It began by stating that the purpose of the letter was to provide the profession’s ‘conclusions on the changes needed in the short-term, on the assumption that the Government wishes to maintain the strength of the MFR basis’.

4.107. The profession noted that it had, in December 1997, suggested changes to the MFR basis to ‘maintain the strength of the MFR basis at the level previously decided by the Secretary of State in light of the changes to ACT credits introduced in the last year’. These original suggestions were: first, that the assumptions in the MFR basis in relation to equity investments should be reduced from 9% to 8.5% for those below MFR pension age and from 10% to 9.5% for those above MFR pension age; secondly, that the equity market value adjustment should be reduced from 4.25% to 3.5%; and, finally, that net dividend yields on the FTSE Actuaries All-Share Index should be used in place of gross dividend yields.

4.108. The actuarial profession continued:

However, since writing that letter, it has become increasingly clear that the performance of the UK equity market over the last 12 months or so has been inconsistent with the underlying principles on which the equity MVA is calculated. This is due to stagnant dividend growth, which appears to be a result of changes in the way companies are rewarding shareholders (for example, due to the tax changes introduced by the July 1997 Budget). What is impossible to tell is whether these are temporary or permanent features. At the same time, there have been substantial increases in market values, resulting in the dividend yield being at a virtually all time low. The result, however, is that the equity MVA has increased to a much higher figure than expected – 152% as at 30 April 1998.

4.109. The letter went on to explain the principal two effects of this – increased MFR liabilities and increased cash equivalent transfer values for those leaving schemes. It continued by explaining that ‘[i]n the longer term, it will be essential to find a more robust method of dealing with changes in the equity market than the current MVA’ and that consideration of this would be part of the forthcoming review of the MFR that the actuarial profession would undertake on behalf of Government.
4.110. The actuarial profession’s letter concluded by setting out the technical basis of their advice.

Submission to Minister regarding MFR reform

4.111. On 13 May 1998, officials made a submission to Ministers in which they were invited to approve the actuarial profession’s proposal for interim reform of the MFR and also to agree to officials meeting the profession to discuss detailed proposals for their long-term review of the MFR.

4.112. The submission set out the background to the issues in some detail and then provided briefing on ‘presentation’. The latter, in relation to the short-term changes to the MFR basis, said:

The short-term changes, which are fairly minor, should cause no difficulty at all for Treasury Ministers. The MVA adjustment to a net figure has in any case already been agreed by Helen Liddell as it was part of the earlier recommendations which she accepted. The further small change to the MVA could be said to help ensure that the value of liabilities adjusts in line with market conditions (which is what the MVA is intended to do).

4.113. The briefing continued:

A long-term review of the MFR basis is likely to attract Treasury interest particularly in view of speculation in the Press that the changes in market conditions have been as a result of the removal of the ACT tax credit last July. We will need to talk to Treasury officials about the longer term review after we have talked to the F&IoA.

We recommend that these changes are kept fairly low key and that a press release is not appropriate. Because of the need to notify their members of the changes, which will hopefully come into effect very soon, the F&IoA are likely to issue a press release in order to notify their members.

4.114. The submission concluded by noting that the actuarial profession were concerned that the MFR valuation method was not sufficiently robust to be able to deal with changes in market conditions and that this would form part of their review of the MFR. Officials said that they expected the actuarial profession’s suggestions on MFR reform ‘to be fairly wide ranging’.

Report of the Pensions Provision Group

4.115. On 4 June 1998, a group of pension experts known as the Pensions Provision Group, which had been commissioned by the Government to examine the levels of pension provision in the UK and also to analyse possible future trends in that provision, published its report, ‘We All Need Pensions: The Prospects for Pension Provision’.

4.116. They concluded that it was:

...even more important that people have good second tier pensions in order to have adequate incomes in retirement and to avoid the need to depend on means-tested benefits, which themselves can have adverse effects on people’s incentives to save for retirement.

4.117. In a subsequent answer to a parliamentary question, John Denham, the then Pensions Minister, said on 16 June 1998 that:

The Pension Provision Group report... identified that many people will face an avoidable drop in income in retirement because they do not make adequate provision for themselves over and above the basic State pension. One of the key issues underlying this problem is the lack of financial awareness and good information on pensions.

The Pensions Education Working Group

4.118. On 16 June 1998, another group, the Pensions Education Working Group, which had been commissioned by the Government to consider the co-ordination, targeting and efficiency of pensions education and to advise
on action needed to improve knowledge of pension issues, published its report, ‘Getting To Know About Pensions’.

4.119. The report made three principal recommendations:

(i) first, that a major pensions education and awareness programme was necessary;

(ii) secondly, that any such programmes should cover a range of initiatives, including personal finance education within the school system and annual and automatic information to be provided by Government and by pensions providers about pension options and entitlements; and

(iii) thirdly, that a programme of pensions simplification was overdue.

4.120. These recommendations were welcomed by the Government, who asked the Group to continue to take forward their work.

4.121. In a press notice published to accompany the report, John Denham, the then Pensions Minister, was quoted as saying ‘people at work and people taking up new jobs need better pensions information’.

4.122. The notice continued:

The Government will examine ways of stressing the benefits of joining employers’ pension schemes and wants to ensure that employees can get good advice about new stakeholder pension schemes at work.

4.123. It then quoted the Minister’s speech that day at the TUC Pensions Conference. He had said:

Today’s report... makes clear that people not only need to understand the importance of saving for retirement, but to have the skills to make the right choice about which pension product is best for them. And today I can announce the first steps in a major campaign to address this.

For the first time, Job Centre staff will stress the importance of pensions to jobseekers moving into work... A new series of user-friendly leaflets will reinforce the message. And improvements will be made to the state pension forecasting system to get the right information to customers.

Revised Actuarial Guidance Note
4.124. In the meantime, on 15 June 1998, the actuarial profession had issued a revised version (1.3) of their guidance note, ‘Retirement Benefit Schemes – Minimum Funding Requirement’. This incorporated guidance to reflect the change to the MFR basis.

DSS research report
4.125. On 8 October 1998, DSS published research it had commissioned on public attitudes to pension provision.

4.126. The press notice announcing publication of the report stated, under a heading ‘report highlights lack of public awareness on pensions’, that the research had shown that ‘...people find the whole area of pensions very confusing and many feel uncertain about their future’.

4.127. The press notice went on to describe the ‘main findings’ of the research, which included:

(i) that ‘the complex and changing pension system is often poorly understood by the public’;

(ii) that ‘pension planning is often limited and belated’;

(iii) that ‘people need more, better and accessible information on pensions, and want the Government to make sure the public is properly informed and advised’; and
that ‘personal pensions are seen as risky, and confusing’ and that ‘occupational pensions are seen as providing a good return’.

**Briefing for Ministers on MFR**

4.128. In a briefing note by DSS officials for a Ministerial meeting in October 1998, in relation to the purpose of the MFR it was stated that:

The MFR is intended to provide a reasonable level of security for members in the event of the sponsoring employer becoming insolvent and no further funds being available to pay into the scheme...

The underlying assumptions were shaken by the decision in the July 1997 Budget to abolish the 20% tax credit on UK equity dividends formerly available to occupational pension schemes, which invest on average about half their assets in UK equities. Adjustments had to be made to the assumptions in the MFR valuation method in June this year to avoid the risk of employers having to put extra funds into their schemes unnecessarily.

4.129. The above formulation was also used in later briefing for Ministers and officials in both DSS and the Treasury.

**The Pensions Green Paper**


4.131. The Paper summarised the Government’s proposals for non-state pension reform as being:

(i) ‘better regulation’ to restore confidence in the system;

(ii) ‘better information on schemes’;

(iii) ‘better information on people’s own need to save’, including the development of annual joint statements of a person’s state and non-state pension provision, ‘so that they can see for themselves if they should save more for retirement’; and

(iv) ‘wider recognition of the benefits of occupational pension schemes and measures to encourage more people to join them’.

4.132. The Paper argued that the Government’s proposals were fair, affordable, provided security and would build ‘a new partnership in pensions’.

4.133. After dealing with the position of people who could not afford to save, and under a heading ‘those able to save – a public-private partnership’, the introduction to the Paper said:

Those who are able to save for their own retirement should do so. For this, they need to have trust in the system; for the right schemes to be available and affordable; to be able to cope with flexible working and variations in earnings...; and to know how much they should save to deliver the income they want in retirement.

4.134. The introduction went on to say that the Government believed that ‘the current system does not meet these needs’. It then described occupational pensions as ‘usually good value and secure and... generally the best choice’. It continued:

Occupational pension schemes are one of the great welfare success stories of this century. They are run voluntarily by employers, or groups of employers for their staff, and provide a pension on retirement and often other benefits.

4.135. It also noted that ‘some confidence in occupational schemes has been lost since the Maxwell scandal’. Furthermore, the Paper noted that while being ‘an excellent means of providing for retirement... the growth of occupational
pension scheme coverage may have peaked’ – due to a decline in the number of people employed in large companies and the public sector, changes in the regulation of occupational schemes, and the move away from final salary to money purchase schemes.

4.136. Under a heading, ‘poor information and lack of trust in the pension system’, chapter 3 of the Green Paper, which set out ‘the need for change’, concluded by saying:

Few people really understand pensions. Few know about their own pension position and the action they need to take to improve it. Added to this lack of understanding, the Maxwell affair and the mis-selling of personal pensions has left many people lacking confidence and trust in any type of pension arrangement. People are not sure where to get advice and who they can trust. Much of the information that is available is of poor quality. Because of this, many people run the risk of making the wrong pension choices, their confidence and trust in pensions may be undermined and they may be put off saving altogether.

If people do not trust any type of pension scheme it can become a reason to do nothing, even though pension savings made early are worth far more than those made late in a working life. If people do not know their own position they cannot judge whether and how to make better provision, or be confident of finding the best way to improve their position.

To overcome these problems action needs to be taken to educate people about pensions and provide better, more secure pension schemes which give them confidence and restore trust.

4.137. Chapter 8 of the Paper was entitled ‘strengthening the framework for occupational pension schemes’ and was introduced by the statement that ‘occupational pension schemes provide a secure pension for millions. We want to build on this success by strengthening the framework for occupational pension schemes and encouraging those who can to join them’.

4.138. Notice was given that the Government was issuing a separate consultation on a package of technical measures it proposed would simplify the contracting-out of schemes and the procedure for the nomination of member trustees (see below).

4.139. The Government also said that it wished ‘to do more to encourage people to join occupational schemes’. In noting the decline in membership of such schemes, the Government said that ‘a continuation of this trend would be counter to our objective of increasing occupational pension coverage in the future’ and also that the Government wanted ‘to reverse this and achieve a significant reduction in the numbers of non-joiners’.

4.140. The Paper continued:

We expect some increase in the take-up of occupational pensions to result from improvements to pensions education. We have already taken steps to ensure that people are better informed about pension issues generally, and about the options available to them as individuals in particular. It is highly desirable that individuals are given the clearest possible statement of the value to them of joining their employer’s occupational pension scheme.

4.141. The Paper, in paragraphs 22 and 23 of Chapter 8, went on to consider the MFR:

We know that one of the areas of concern to employers is the MFR. The concept behind the MFR is a straightforward one – that is, people who have built up pension rights should be able to draw their pensions in full, even if the employer is no longer there to pay extra contributions. But devising a method of securing
pension rights without imposing too much of a burden on employers is not so straightforward. We are asking the actuarial profession to look again at the present valuation method, and consider whether there are different ways of delivering the level of security we feel is right. There will need to be full discussions about any proposals.

We are also considering the viability of a Central Discontinuance Fund to which pension rights might be transferred when a scheme has to wind up because the employer is insolvent. We will be looking at this as part of our review of the MFR.

4.142. Chapter 8 continued with a discussion of possible reform to the provisions related to guaranteed minimum pensions and contracting out and the removal of regulatory burdens from certain schemes. It ended with a summary of the Government’s proposals for strengthening the framework for occupational pensions, two of which were proposals to make ‘improvements to the compensation scheme’ and to ‘encourage improvements in transparency and accountability’.

4.143. In proposing improvements to the arrangements for the protection of members of occupational pension schemes where the employer was insolvent and where the assets of the scheme had been lost because of theft or fraud, the Government said:

The present compensation rules could produce potentially very unfair results for members of salary-related pension schemes. When such a scheme winds up, pensioners generally have priority over other members. Therefore in a mature scheme, where many of the members are pensioners, active members could receive very little of their expected benefits.

It is an important principle that consumers should exercise care in the choices they make. This principle applies to pension scheme members who have access to information about how the scheme is run, the ability to nominate trustees and to complain if they think things are going wrong so that investigations can be carried out. It would not, therefore, be appropriate to provide 100 per cent compensation. But we believe it is possible to introduce a more equitable scheme consistent with this principle, which would be of particular benefit to members of mature schemes.

4.144. The Paper continued:

For salary-related schemes, we propose that the calculation of the amount of compensation payable should be based more closely on the age profile of the members. So instead of limiting the funding to 90 per cent of all the scheme’s liabilities, we will increase it to 100 per cent in respect of pensioner members and those who are within 10 years of the scheme’s pension age (who have to be identified already for the MFR valuation). That means that, when the scheme’s assets are allocated to meet individual pension rights, there would be a greater chance of providing younger members with a fair value of their basic pension rights, whilst preserving in full the level of pensions that are already in payment.

4.145. Chapter 10 of the Paper was entitled ‘education and trust’. It began with the statement that:

...people are confused by the many pensions options and have lost faith in the system. We need to help people to understand how they can ensure they have the level of income in retirement that they want and which type of pension is best for them. We need to rebuild trust so that people will save with confidence.

4.146. It continued:

People need better and more accessible information about state and non-state pensions. They need to know where to get information and
advice from sources they can trust. At the moment much of the general and personal advice given is of variable quality. People rightly want trustworthy, clear and impartial information and want the Government to facilitate access to simpler products and better and more meaningful advice. That is our challenge.

4.147. The Paper said that one of the ‘clear’ and ‘key’ principles that underpinned a pension education and awareness programme was that ‘individuals need clear information and advice on alternative forms of pension provision to make the right pension choices’. It continued:

We believe it is necessary to bring about a radical improvement in the quality and accessibility of information on pensions, both in general and in the information people are given about their own pension position. We will work closely with the Financial Services Authority to improve the general quality and comparability of pensions information...

The Government and the financial regulators have the central role to play in developing the long-term framework and for driving forward the specific initiatives needed to improve pensions information. In turn, we believe that the private sector can provide expertise, ideas and enthusiasm to make a significant contribution in many areas. In partnership, we can press ahead with a dynamic and effective programme of action to counter lack of awareness, interest and understanding of pensions.

4.148. In describing the work that the Government and the FSA would be doing in the wider financial context, the Paper said:

Any improvement in pensions information and public awareness will only have maximum effect if individuals have the basic skills to interpret information and understand the overall financial context in which decisions are made. This will include promoting awareness of the benefits and risks associated with different kinds of investment and providing appropriate information and advice.

4.149. In setting out the detailed work programme to take forward the Government’s agenda, the Paper categorised this as involving personalised pensions information, work-related advice (including the need to emphasise ‘the importance of occupational schemes’), and general pensions information. In relation to the latter, the Government proposed to issue new DSS pensions leaflets, complemented by a marketing campaign, to support the promotion of financial education in schools, the piloting of pension information helplines and also the development of a Plain English guide to pension terms.

4.150. It then dealt with some new DSS leaflets, which had recently been issued (see above), and said:

We published a new series of DSS pension leaflets in June 1998 which help to meet the need [for standardised and simplified pensions information and a general introductory document issued by the Government]. The leaflets are concise, accessible and relate information directly to decisions individuals need to take at various life stages. The leaflets met the Plain English Crystal Mark standard and have been awarded the Money Management Council Quality Mark for providing clear and unbiased information on money matters. We are running a nationwide marketing campaign to promote the leaflets.


The ‘technical’ consultation document

4.152. At the same time, the Government issued a consultation document, entitled ‘strengthening the pensions framework’, which set out the more
detailed or technical proposals that were referred to in the Green Paper.

4.153. In the introduction, the then Minister, John Denham, said that the focus of the consultation was on measures related to contracting-out procedures and also on some amendments to the provisions of the Pensions Act 1995. He continued:

People should be encouraged to join their employer’s occupational pension scheme where, as it usually is, it is in their best interests to do so. But they will only do so if they believe their pension rights are properly protected. Security is of paramount importance. But we must also avoid actions which will deter employers from continuing to run occupational pension schemes. So it has been important to allow most of the major changes introduced by the Pensions Act to settle in before deciding what further action is necessary. It is costing schemes and employers some effort and money to meet the requirements of the Pensions Act, and we do not want to increase their costs unnecessarily, or to discourage employers from sponsoring and supporting occupational pension schemes.

We already know from those who run and advise pension schemes, that there are some simplifications which should be made now. We want to achieve simplifications where we can reduce the burden on schemes without adversely affecting the security of members’ rights.

4.154. The document, in part 4, set out suggested improvements to the framework provided by the Pensions Act 1995. It explained:

Pension funds can work effectively only if their members can have confidence that the benefits promised to them when they are working will actually be delivered when they retire. The Pensions Act 1995 and the regulations made under it have provided increased security for members. There remain, however, restrictions and inconsistencies which we believe create or perpetuate unfair treatment.

4.155. The paper then went on to suggest ways to remove these restrictions and inconsistencies and it sought responses to the proposals by 12 February 1999.

Compensation for NIRS2 delays

4.156. Alistair Darling, the then Secretary of State for Social Security, announced on 1 February 1999 that he would be bringing forward measures to compensate those who had suffered financial loss due to delays in the receipt of social security benefits that had been caused by problems with the Government’s NIRS2 computer system.

4.157. In the official press release, he was quoted as saying that he had been ‘concerned for some time about these delays and [was] determined that any inconvenience suffered by those who would otherwise not get anything should be properly recognised’.

Commons debate on Government pensions policy

4.158. On 3 February 1999, the Opposition launched a debate on the pensions policy of the Government through a motion which argued that:

...the Government has failed pensioners and thrown away a unique opportunity for reform... [we deplore] their attack on pensioners through the abolition of the [advance corporation tax] dividend tax credit, which will cost pensioners and all future pensioners £5 billion per year; [we believe that] the Government has further hurt occupational schemes by increasing the regulatory and cost burden in the pensions Green Paper; [we reject] the Government’s proposals, which will make pension provision more complex and offer no real security for pensioners in the
future; and [we condemn] the Government for their extensions of means-testing in the welfare and pensions system, which will undermine the incentive to save.

4.159. Answering the debate, Mr Darling said:

We firmly believe that everyone who can save ought to save. We want to give people the flexibility, the choice and the incentives to do so. A one-size-fits-all approach to pensions will not do; everyone has different requirements.

There have been huge labour market changes. In the past, many people had access to occupational pension funds, which are extremely good options for those who are lucky enough to be able to take advantage of them. As the House well knows, however, many people do not have that option. Although personal pensions are certainly a good option for some, they are not so, as we know only too well, for low-paid people or even for some moderate earners.

4.160. He continued:

Above all, the Government must ensure that people have a range of options. We must increase flexibility to ensure that as many people as possible save. That is our objective: we want people to save more, invest more and to ensure that they can provide for themselves adequately in their retirement... It is very clear: we are telling people to do the best that they can for their retirement.

Welfare Reform and Pensions Act 1999

4.161. Following both the consultation exercises referred to above, the Government implemented some of its proposals through secondary legislation, such as the introduction of a new requirement that scheme trustees should provide information to members about their policy on ethical investment.

4.162. Other proposals, which required primary legislation, were set out in a Welfare Reform and Pensions Bill, which received its Second Reading in the House of Commons on 23 February 1999.

4.163. The Bill:

(i) established the framework for the introduction, sale and regulation of stakeholder pensions;

(ii) made amendments to the regulatory framework for other pensions;

(iii) enabled the courts to order that pensions could be shared on divorce like other assets;

(iv) made changes to the provision of bereavement benefits;

(v) reformed incapacity benefit and some of the provisions of disability living allowance; and

(vi) introduced a new ‘single work-focused gateway’ to handle claims for unemployment benefits.

4.164. The changes to the regulatory framework for pensions included provisions related to the monitoring of employers’ payments to personal pension schemes; dealing with late payments by employers to occupational pension schemes; the effect of insolvency on unapproved pension rights; the forfeiture of rights under pension arrangements; and the compensation arrangements for members of occupational pension schemes which had lost assets due to fraud or other dishonesty.

4.165. The then Secretary of State for Social Security, Alistair Darling, in moving the Second Reading of the Bill, informed the House that the aim of the pension reform aspects of the Bill was ‘to ensure that the system provides security in retirement for future pensioners and allows pension sharing on divorce’.

**Announcement of MFR review**

4.167. On 3 March 1999, DSS issued a press notice announcing the review of the MFR. The notice explained:

*The review's aim is to find the best way to safeguard the pension rights of those in occupational pension schemes. The review will focus on the valuation method, and consider fundamental changes in approach to the existing system.*

*Mr Timms [the Pensions Minister] said:*

“The terms of reference of the review are thorough and wide-ranging. The aim is to find ways to protect people’s pension rights that are reasonable and affordable. The work will not be straightforward. The issues that need to be addressed are complex and will require careful consideration. We shall be taking this forward in partnership and are grateful for the help provided by the profession. The review of the Minimum Funding Requirement is part of the process to strengthen the framework for occupational pension schemes.”

The review of the MFR will be carried out by the Faculty and Institute of Actuaries Pensions Board in conjunction with the Department of Social Security. There will be full discussion of any proposals.

**DSS consultation on a quality accreditation scheme**


4.169. The central aim of this initiative, according to the Foreword by the Pensions Minister, was to raise standards and to encourage the spread of best practice in all occupational pension schemes, with a view to reinforcing the role of employers in pension provision and of providing employees with confidence in the quality of that provision.

4.170. One of the proposed criteria on which applicants for accreditation would be judged was ‘scheme communication’. Each applicant scheme would be assessed as to whether it provided ‘clear information about the structure of the scheme and the benefits available to all members and prospective members’.

4.171. The accreditation scheme was later dropped.

**Parliamentary questions on reform of the MFR**

4.172. On 19 March 1999, Stephen Timms, the Pensions Minister, replied to a question from Nick Gibb MP who had asked for details of who would be undertaking the review of the MFR.

4.173. The Minister replied:

*The Pensions Board of the Faculty and Institute of Actuaries have been asked to carry out the review in partnership with this Department. The Department is also advised by the Government Actuary. The Pensions Board may decide to set up technical working groups to research particular aspects. The Confederation of British Industry, Trade Union Congress, National Association of Pension Funds and the Association of British Insurers have been invited to comment on the scope of the review.*

4.174. On 29 March 1999, the Minister also replied to a question from David Heathcoat-Amory MP, who had asked when the review had been announced. The Minister replied that the terms of reference for the review had been announced by means of the press notice issued on 3 March 1999 (see above).
OPRA support for plain English and clear communication

4.175. On 27 April 1999, OPRA issued a press notice, to coincide with the launch of the Plain English Campaign’s guide to pension terms, in which OPRA recorded its support for the proposition that schemes should ‘treat communication as an opportunity, not a chore’.

4.176. It began:

A good company pension scheme is often the best perk of the job – and sometimes the best kept secret as well.

4.177. The then Chief Executive of OPRA was then said to have ‘urged everyone involved in running pension schemes to cut through the jargon and to get people as wised up about their pension benefits as about their other job perks’, and was quoted as saying:

The law which OPRA enforces sets out what company pension schemes have to tell their members, but it doesn’t set out the words they should use to do this. This means that some pension schemes comply with the law – aimed at involving and empowering the members – yet still produce information that baffles and excludes people.

OPRA ‘guide to the MFR’

4.178. On 1 May 1999, OPRA published a ‘guide to the MFR: a summary for pension scheme members’. The Foreword by the then Chairman of OPRA stated that:

...this is only a guide and is not a definitive statement of the law. You 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.

4.179. In a section entitled ‘what is the MFR?’, the guide said:

A scheme that complies with the MFR will either already be funded to at least the minimum level required by the law or will be aiming to have that level of funding within certain time limits. This will not necessarily ensure that all of a scheme’s liabilities can be met fully if the scheme were to be wound up. However, the MFR sets a benchmark against which the trustees must measure the funding level of a scheme. The MFR means that any shortfall below that benchmark must be corrected.

4.180. After dealing with the types of scheme covered by the MFR, the funding timescales and other corrective action required of schemes that were not fully funded, the position of multi-employer schemes, penalties which trustees would be liable to incur should they not discharge their responsibilities appropriately, and the actuarial methods employed, the guide then set out the detailed provisions related to – and the timetable for undertaking – MFR valuations and other related matters.

4.181. This edition of the Guide did not repeat the statement in an earlier, 1997, edition of the Guide that ‘the MFR refers to the minimum amount of funds that should be in the scheme at any one time in order to meet the schemes liabilities if it were to be discontinued’.

The winding-up consultation


4.183. Stephen Timms, then as now the Pensions Minister, in the Foreword to the document, said:

The process of winding-up occupational pension schemes has always been problematic... Many members of schemes that are being wound-up cannot see why it is taking so many years for
them to get their pensions sorted out – and often show a deep frustration when there appears to be nobody to turn to who can make things happen.

We want to do something about that. We realise schemes which have been contracted-out are facing added difficulties and delays because the new NIRS2 computer system is not producing membership lists and schedules of Guaranteed Minimum Pension liabilities. But that problem will be tackled later this year. In the meantime, we need to make headway in addressing other causes of delay.

4.184. He continued:

The winding-up of an occupational pension scheme can be a very complicated and traumatic process, particularly where winding up has been triggered by the insolvency of the sponsoring employer. The long time often taken for the process to be completed, and the uncertainty for members during this time, can make members feel particularly vulnerable.

It is a process which we all would like carried out properly and as quickly as possible. We want to make sure that action is taken promptly but also allow the trustees enough time to be able to carry out all that is required of them under trust law, scheme rules and legislation, and in the best interests of members.

4.185. The focus of the proposals, he said, was to be the provision of additional powers to OPRA to oversee the winding-up process and to allow it to intervene where it considered that the process was being unreasonably delayed.

4.186. After describing the background to the consultation and the process of winding-up, including the responsibilities of scheme trustees, the document set out the Government’s understanding of the ‘causes of delay’ in a process where it recognised that six or more years to wind up a scheme was not unusual.

4.187. The factors listed by the document included:

(i) poor scheme records which led to delays in determining who scheme members were and to what they were entitled;

(ii) the time taken to appoint an independent trustee;

(iii) difficulties in getting access to documentation from an insolvent sponsoring employer’s files or in retrieving such from the relevant insolvency practitioner;

(iv) discrepancies and other difficulties in reconciling contracted-out liabilities;

(v) ambiguities in scheme rules which required subsequent interpretation in the Courts to resolve disputes;

(vi) delays caused by the need for scheme trustees to seek legal advice on how legislative change over time had affected the calculation of members’ benefits; and

(vii) difficulties in tracing scheme members, especially those deferred members who had not provided up-to-date contact information since leaving the employment of the sponsoring company.

4.188. The document noted that, with respect to the problems in the reconciliation of contracted-out liabilities between scheme records and those held in national insurance records, there was no provision in the relevant legislation for flexibility in the process, for example on a de minimis basis. It also noted that ‘there is evidence that scheme administrators contribute to the delay by taking a long time to respond or query details’ with the Contracted-Out Employment Group of the then Contributions Agency of DSS, which it was subsequently announced – at the time of the
March 1998 Budget – would become part of NICO from April 1999.

4.189. The document explained, however, that:

_There have always been concerns about the length of time taken to agree contracted-out liabilities... However, the difficulties are exacerbated by the current NIRS2 computer problems._

4.190. Part II of the document set out the Government’s proposals for legislation and asked five questions:

(i) in relation to a proposal to require scheme administrators to notify OPRA where no independent trustee had been appointed within three months of the sponsoring employer’s insolvency, the Government asked whether this requirement should be extended to scheme professionals such as actuaries and auditors and also whether the three month period was reasonable;

(ii) in relation to a proposal to enable OPRA to amend scheme rules to enable the speedy completion of the winding-up process, the Government asked whether trustees should be required to seek the consent of their members before asking OPRA to do this;

(iii) in relation to a proposal to require trustees to report to OPRA where a scheme was still being wound up three years after the commencement of that process, the Government asked whether the three year period was appropriate and also whether such reports should be provided thereafter on an annual or other basis;

(iv) in relation to a proposal to give OPRA the power to direct specified action on the part of someone involved in the winding-up process, the Government asked whether the proposed powers were directed towards all of the appropriate people; and

(v) in relation to a proposal to extend the existing provisions for the disclosure of information to scheme members and, in particular, to require trustees to provide members with an indication of the benefits that they might in due course expect once three years from the commencement of wind-up had elapsed, the Government asked whether there was other information that members should be given at this time.

4.191. The issues were summarised on pages 14 and 15 of the document. It stated there that ‘poor records is a fact of life – but should improve over time’ and that ‘reconciling contracted-out liabilities should be quicker once NIRS2 is fully operational’.

4.192. Responses to the consultation were sought by 2 July 1999. In the press notice which accompanied publication of the document, the Minister was quoted as saying that ‘these proposals are the first step in speeding up the process by introducing some accountability and enabling action to be directed where needed’.

**Revised Actuarial Guidance Note**

4.193. On 1 June 1999, the actuarial profession issued a revised version (1.4) of their guidance note, ‘Retirement Benefit Schemes – Minimum Funding Requirement’. These made minor technical changes to professional guidance which are not of relevance to the heads of complaint.

**FSA guides**

4.194. In June 1999, the FSA issued a ‘guide to the risks of pension transfers’. It stated, in relation to final salary schemes, that ‘you are guaranteed a certain level of pension when you retire, as well as other benefits’. It also referred, when an individual received a cash transfer value to...
transfer from a final salary scheme to another pension vehicle, to such a value as being a sum that ‘reflects the benefits that were guaranteed’.

4.195. It continued:

If you transfer from a final salary scheme to a money purchase scheme run by a new employer or to a personal pension, you give up the promise of a guaranteed pension. What you get instead is a pension whose value depends on how well the invested money grows. You, rather than the employer, carry the risk if the investments perform badly.

4.196. The guide went on to explain the need to seek proper advice but cautioned, in a position where a financial adviser suggested that the reader transfer out of a final salary scheme, ‘that, with a personal pension, you will give up any guarantees you had in the former employer’s scheme’.

4.197. In another guide published at the same time, entitled ‘guide to the risks of opting out of your employer’s pension scheme’, the FSA said that final salary schemes ‘offer guaranteed benefits’ and explained that ‘you should not be advised to opt out of your employer’s pension scheme unless there is a very good reason to do so... think very carefully before you opt out of your employer’s scheme’. It also stated that final salary schemes ‘give you a guaranteed pension. The amount of pension you get from a personal pension is unpredictable’.

4.198. Later editions of these guides were amended to remove the above references.

GAD letter to DSS on MFR
4.199. In a letter dated 9 June 1999 from a GAD directing actuary to a DSS official, which discussed the strength of the MFR in the context of the ongoing review of it by the actuarial profession, the directing actuary wrote:

The whole issue of the conflict between the MFR and the benefits which individuals are likely to get from a scheme if it winds up and buys out some or all of the liabilities is a fundamental problem. I am still waiting for the whole edifice to collapse once the first big scheme goes through that process and members complain that they did not get their fully accrued benefits in spite of this scheme having assets equal to 100% of its MFR liabilities. I think it is likely that this aspect will be given prominence by many members of the profession and the particular focus of it in relation to pensioners will be highlighted, so this particular issue is likely to feature highly in the radical options.

OPRA press notice about its guide to the MFR
4.200. On 19 July 1999, OPRA issued a press notice to advertise the fact that it had published a guide to the MFR for pension scheme trustees.

4.201. It said:

...the aim of the booklet is to help give trustees a better understanding of the issues involved in complying with the MFR. Much of the technical work in this area will be carried out for trustees by experts such as actuaries. But trustees still need a grasp of the subject to be able to ask the right questions and understand fully the advice they are given.

The Best Practice Guidelines Working Group
4.202. On 22 July 1999, DSS announced that it had established a new working group, with members drawn from the pensions industry, industry leaders, and the trade union movement and chaired by the Department.

4.203. Its role would be to advise on the development and promotion of best practice guidelines for occupational pension schemes.
4.204. In July 1999, the FSA published a factsheet entitled ‘joining or rejoining your employer’s pension scheme’.

4.205. The factsheet explained that it aimed to provide general information about why the reader might have been ‘better off in your employer’s pension scheme’ and to set out the main points that needed to be thought about when deciding whether to join or rejoin such a scheme. It also indicated other sources of information. The factsheet then defined the types of scheme to which it referred and explained the rationale for taking prompt action in the context of the personal pensions mis-selling review.

4.206. Under a heading ‘will I be better off if I join or rejoin my employer’s pension scheme?’, it suggested that ‘you will nearly always be better off in your employer’s pension scheme rather than in a personal pension scheme’.

4.207. After setting out the key characteristics of the benefits provided by occupational pension schemes, the factsheet contained a section called ‘is my employer’s pension scheme in financial difficulties or being “wound up”?’

4.208. This section said:

Occasionally, an employer’s pension scheme may run into financial difficulties. This means there is a chance it may not be able to pay benefits in the future. And sometimes, even if there are no financial difficulties, some employers just decide to close down their pension scheme. The scheme may then be ‘wound up’.

These situations don’t happen very often but it is worth checking they don’t apply to your employer’s pension scheme. You can check this by writing to your employer (or to the scheme trustees). Ask them to confirm in writing that there are no plans to ‘stop benefit accrual in the pension scheme’. If they cannot confirm this, then you are almost certainly better off not joining or rejoining now.

If your employer’s pension scheme is a ‘final salary scheme’, you should also ask if ‘the latest actuarial statement (made under the Disclosure Regulations) confirmed that the assets of the scheme fully covered its liabilities as at the valuation date’. If they cannot confirm this, then again you are almost certainly better off not joining or rejoining now.

If you are in any doubt about your position, you should contact an authorised financial adviser.

4.209. The factsheet then signposted readers who wished further information to other FSA publications, including those referred to above. A revised edition, which reproduced this section, was produced in September 2001.

Consultation on stakeholder pensions

4.210. On 2 August 1999, DSS issued a consultation document as part of its series of consultations on the new stakeholder pensions. This document was called ‘regulation, advice and information: the Government’s proposals’.

4.211. Paragraph 26 of the document dealt with information provided by Government or regulators:

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 to pensions... 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.
**Further Ministerial briefing and meeting with actuaries**

4.212. On 16 November 1999, Jeff Rooker, the then Minister for Pensions, met representatives of the actuarial profession following submission to DSS of the preliminary findings of their review of the MFR in a draft progress update on that review.

4.213. In the briefing for that meeting, DSS officials suggested that, in the meeting, the Minister should, in relation to the draft finding related to what members knew about the real purpose and strength of the MFR, ask the actuaries to:

...expand on the premise that members believe that the MFR is a solvency guarantee. Is it not up to trustees to ensure that the position is communicated to members?

4.214. Additional briefing, which described the background to the MFR, was annexed to the note, and stated that:

The MFR valuation is a discontinuance test... but it is not a guarantee of solvency. Although the valuation of pensioner liabilities should reflect the cost of securing those liabilities by annuities, the calculation of non-pensioner liabilities does not. Ministers at the time felt that it would impose an unreasonable burden on employers of ongoing schemes to require them to fund on the basis of being able to fully secure all liabilities with guaranteed annuities should the scheme wind up.

The objective of the MFR is that a scheme fully funded according to the MFR would, if the employer became insolvent, protect fully the pensions already in payment, and provide members with a transfer value that would give them an even chance of replicating scheme benefits if they transferred to an occupational or a personal pension scheme. It should not impose unreasonable costs on employers...

4.215. It continued:

The removal of tax credits on UK equity dividends in the July 1997 Budget reduced the rate of return on UK equities and had the effect of weakening the MFR test as prescribed at that time. In June 1998, following recommendations from the [actuarial profession] a short-term change was made to the MFR valuation method concerning the rates of return on investment from equities in order to try to maintain the intended strength of the MFR.

4.216. At the meeting, the actuarial profession also tabled a ‘briefing note’ for the Minister, which set out some proposals for ‘short-term changes’ to the MFR.

4.217. After noting that there had been two ‘significant changes’ since the establishment of the MFR basis – the sharp decline in inflation and in interest rates and improved pensioner mortality – the actuaries then set out two proposals ‘to maintain the basis at the level of strength which it had when it was originally established’, namely:

- Making allowance in the valuation of pension increases for the possibility that price levels may at times fall. In this case, pensions would not actually be reduced. In current circumstances this would increase the accruing (future service) MFR liabilities of most schemes by about 3.5%. The increase in the accrued (past service) MFR liabilities depends on the type of pension increase awarded in payment on pre-97 accrued pensions. There will be no effect on this significant part of the accrued (past service) liabilities for schemes which gave a fixed guaranteed increase or no increase at all; and
Reducing the mortality rates in the MFR basis by two years, producing an increase in the accrued (past service) and future liabilities of about 6.5%.

4.218. The briefing then went on to note that:

...the effect on individual schemes would depend on the mix between pensioners and non-pensioners and the manner in which pre-97 accrued pensions are increased in payment. But the combined effect of these two changes would be an increase in the accrued (past service) MFR liabilities of between 6.5%-10%, i.e. a reduction in MFR funding levels of between 6.5% and 10%. This would, in the view of the profession, provide the same strength of the MFR as that which was intended at the time it was originally established.

4.219. The briefing then said that a transition period or a period of advance warning would be needed to enable sponsoring employers and schemes to adjust to the new MFR level that was proposed, which might involve increased contributions.

4.220. The briefing note concluded with the statement that:

...we recognise that the final decision as to whether to make any change to [the Guidance Note that set out the MFR basis] is for Government. Clearly there are political implications arising from any change to [it] which has a significant financial impact. On the other hand, if no change is made to [it] there will be implications for the degree of security of members’ benefits. The profession’s role, as agreed with the previous Government when MFR and [the Guidance Note] were first introduced, is to make recommendations to Government as to how it can best achieve its political objectives.

4.221. On 18 November 1999, a directing actuary at GAD wrote to the DSS to set out his view on the actuarial profession’s proposals. He set out arguments for and against both the proposed mortality change and the proposed interest rate change, and also set out some arguments as to whether any change should be made at all at that time.

4.222. On 26 November 1999, another DSS official wrote to an officer of the actuarial profession with a suggested draft outline for a discussion paper that might be issued by the profession in order to comply with its rule that any changes to the Guidance Notes it issued should be subject to consultation with relevant members of the profession. The discussion paper was later circulated in draft on 6 January 2000, for comment.

4.223. The DSS official offered a draft introduction to the proposed discussion paper, which set out the purpose of the MFR thus:

The current objective of the MFR is that a scheme fully funded according to the MFR would, if the employer became insolvent, protect fully pensions already in payment, and provide younger members with a transfer value that would give them an even chance of replicating scheme benefits if they transferred to an occupational or a personal pension scheme. This objective was decided by Government; the valuation method to meet the objective was devised by the Pensions Board of the Faculty and Institute of Actuaries.

4.224. On the same day, briefing was provided for a lunch meeting that the then Permanent Secretary of DSS would be having on 6 December 1999. It included the statement that ‘the MFR is intended to provide a reasonable level of security for members in the event of the employer becoming insolvent and no further funds being available to pay into the scheme’.
Parliamentary question on GMP delays

4.225. Meanwhile, on 24 November 1999, the then Economic Secretary to the Treasury answered a question from Christopher Chope MP, who had asked how many applications for the calculation of GMP entitlements had been awaiting decisions for more than one year, more than two years, more than three years, and more than four years.

4.226. She replied that ‘none of the 7,615 applications for GMP calculations presently awaiting decision are over one year old’.

The Actuaries’ report on communication and the MFR

4.227. Also in November 1999, a research working party of the Faculty and Institute of Actuaries produced a report entitled ‘Communication of MFR and Solvency’. The working party, which had been established by the profession in 1997, met between December 1997 and January 1999 and had the following as its terms of reference:

...to consider how best to communicate to relevant parties how solvency should be assessed, including the role of the MFR in this process. The work will therefore extend beyond the MFR to consider other aspects of communicating solvency and other aspects of communication in general.

4.228. The objectives set for the group were to prepare advice to members of the profession on the importance of communicating clearly to pension scheme members, trustees and sponsors about pension scheme solvency – especially in relation to the MFR; to consider what means should be used for communicating the solvency position of a scheme and solvency issues in general; to consider the terms and language which should be used to describe the solvency position of a scheme; to consider whether a general communication about the issues surrounding pension scheme solvency and the MFR was required and, if it was, to whom it should be addressed and what it should say; and, in the light of actual or proposed changes in the MFR, to consider what general communication should be issued by the profession.

4.229. The report noted that ‘in broad terms... the aim of the MFR test is to ensure a scheme has sufficient funds to keep paying benefits for members whose benefits are in payment and to pay minimum transfer values for other members’. The group also noted that true solvency was only achieved if a pension scheme had sufficient assets to secure all of its liabilities with an insurance company, that the MFR was not designed to achieve this, and that this was not widely understood.

4.230. Under a heading, ‘where are the MFR and solvency currently confused?’, the report listed a number of official, professional and other publications in which pension fund solvency was discussed. It also set out relevant actuarial guidance on the topic.

4.231. With reference to the OPRA booklet ‘a guide for pension scheme trustees’, the report said that one statement in it was factually correct but misleading. The report also noted that scheme communications to members ‘do not generally cover solvency’.

4.232. The report continued to express concern that, for the most part, press comment had equated funding to 100% on an MFR basis with having sufficient assets to meet a scheme’s liabilities in full in the event of a wind-up.

4.233. Section 4 of the report dealt with the ‘consequences of changing the strength of the MFR’.

4.234. It began:

The complexity of the MFR test means that few people understand it fully. This means that if
changes go beyond simple adjustments to the specific actuarial assumptions, the consequences are likely to be difficult to understand. Even simple adjustments to the specific actuarial assumptions might mean that the MFR test is strengthened for some schemes and weakened for others. If the methodology and actuarial assumptions are altered it may be difficult to generalise about whether the test is stronger or weaker. There is also the likelihood that in some possible future conditions a revised MFR test will be weaker, but in other conditions it will be stronger.

Any changes to the strength of the MFR bring into question the level at which it was previously set and may undermine the public's (including trustees', employers' and members') faith in those who set the MFR. In addition, given the lack of understanding of the background to the MFR, some actuaries may be confused by the change.

4.235. The report continued by assessing the implications both of strengthening the MFR basis and of weakening it. The implications of weakening the basis were said to include a reduction in the value that would be given to those wishing to transfer their accrued rights to another scheme. In addition, another implication was that:

...a scheme which was winding up and which had a 100% MFR funding level after the weakening would be able to provide less by way of deferred annuities than one which had exactly the same liabilities and which had a 100% MFR funding level before the weakening.

4.236. The report argued that there needed to be greater general understanding of ‘what the MFR is and what it is not’.

4.237. Section 5 of the report was entitled ‘what needs to be communicated?’ and started with the statement that the group believed that ‘there are fundamental misunderstandings of the MFR throughout the pensions industry’.

4.238. In order to systematically correct these misunderstandings, the report concluded that there were four ‘key concepts that need to be addressed’. These were:

(i) that the MFR did not guarantee solvency;
(ii) the true purpose and nature of the MFR;
(iii) why changes might be made to the MFR and the consequences of any changes; and
(iv) that the MFR was set by the Government after consultation with interested parties.

4.239. In relation to the first concept, the report said that ‘arguably, the various parties involved with the creation and operation of the MFR have failed to address the confusion that has arisen since the idea was first proposed’.

4.240. The report went on to suggest that, because of the complexity of the MFR, efforts to communicate about it should be focused on the ‘concept’ rather than on the ‘detail’. It continued:

...irrespective of the reasons for the confusion between the MFR and solvency, we believe it is incumbent on the profession who are seen as the ‘guardians’ of the MFR to act to correct the confusion. All parties involved with pensions need to understand that the usual concept of solvency is not directly addressed by the MFR. A scheme 100% funded on the MFR basis does not necessarily have sufficient assets at any point in time to secure all guaranteed benefits. It is therefore not necessarily “solvent” as most people would understand the concept and as we have previously defined it.

4.241. The group continued to suggest that, if the confusion between the MFR and scheme solvency could be corrected, then what the MFR
actually constituted should at the same time be addressed:

We need to ensure that relevant parties understand that the MFR provides no guarantees on the payment of benefits...; that it is possible to satisfy the MFR as an ongoing scheme but be mismatched so that there is a deficit on wind up...; that it is not definitive and immovable – it is simply a ‘line in the sand’... which attempts to balance members’ security with the desire of employers to avoid tying up working capital in a pension scheme; that it is one of a package of protections introduced by the Pensions Act 1995, and it cannot do the job on its own; that by taking a pragmatic approach to improving security as measured by scheme funding levels, the risk that final salary benefit provision will not be able to continue as a viable option in the face of competition from defined contribution alternatives is minimised; and that it is a complex calculation overseen as a result by the relevant body of experts – the actuarial profession.

4.242. The report then went on to explain that, if ever the MFR were to be changed, the reasons for the change should be clearly explained and quantified, as should the implications for scheme solvency and the fact that responsibility for the change rested with the Government.

4.243. Section 6 of the report went on to discuss the communication of the above, in terms of how such should be achieved and with whom.

4.244. After considering communication with the rest of the actuarial profession, the report went on to suggest redrafting of the OPRA guide referred to above ‘to avoid any ambiguity about the MFR’ and that the actuarial profession should take the lead in drafting simple factsheets that scheme trustees could issue to members to explain the statutory basis of scheme funding.

4.245. In a section dealing with communication with pension scheme members, the report noted that:

...it would be very difficult for the profession to communicate directly with scheme members in a systematic manner. Therefore, Scheme Actuaries should encourage trustees to provide members with the information necessary to address any incorrect perceptions of the MFR. This task is an onerous one for trustees, unless they can be provided with the material they require. It should always be borne in mind that all parties have an interest in ensuring that scheme members fully understand and appreciate their pension schemes. The material covered... above should be sufficient for this purpose if accompanied by clear instructions on the course recommended by the actuary. Members will also have access to the actuarial valuation, actuarial certificates and Annual Report as well as their Scheme Booklet.

4.246. The report then dealt with issues related to communication with sponsoring employers, trades unions, regulators (OPRA had been sent a copy of the report in draft), other professions and the press.

4.247. In relation to Government, the report said that:

The situation with Government requires sensitive handling. On the one hand we need to make it clear that the ultimate responsibility for the existence, shape and strength of the MFR lie squarely with the Government. On the other hand we want to influence them in order that the MFR works to best effect and to ensure that we continue to be consulted by them in advance of any changes to it. Given the heavy workload of relevant Government ministers, and the fact that they may not be technical experts in the Pensions arena, we suggest that regular briefings on
relevant topics are the best approach. These could be built up from the Factsheets referred to earlier.

4.248. The report concluded:

Although there are a number of problems with the current understanding of solvency vis-à-vis the MFR and funding we do not think that they are, in any way, insoluble. While Pensions in general, and Final Salary/Defined Benefit Pensions in particular, will never be easy to understand we do not believe that the situation is hopeless either. If the Recommended Actions [we have] listed... are followed we feel that this important topic will be clearer to all concerned and the debate about funding of pensions will be a more informed one as a result.

Press comment on MFR reform

4.249. On 6 December 1999, in the light of press interest in the rumoured changes to the MFR, further briefing was prepared for the DSS press team by the same official who had produced the November 1999 briefing. It replicated the explanation provided in earlier briefing (see entry for 16 November 1999, above) but added a further sentence. This stated ‘there has been concern that the valuation method is not as robust as originally expected under changing economic conditions and that it should be re-examined’. This briefing was also incorporated into more detailed briefing, provided on 9 December 1999 in response to an article in the Financial Times about the changes, and was also reproduced in later briefings.

Internal discussions on MFR review

4.250. On 13 December 1999, the actuarial profession responded to a DSS request to provide further explanation of their proposed short-term changes.

4.251. On 10 January 2000, a tripartite meeting – one of a series of such meetings – to discuss the MFR review was held between the Treasury, DSS and the Debt Management Office. The fifth item on the agenda was discussion of the actuarial profession’s proposals for short-term changes to the MFR basis.

4.252. According to the note of the meeting, a Treasury official expressed concern that the draft discussion paper (see above), circulated by the actuarial profession prior to issue to its members, ‘was recommending a strengthening of the underlying objectives of the MFR’. The meeting agreed to inform the actuaries that their paper needed ‘to be much clearer on whether a proposal produces a standard that is the same, stronger or weaker than the objectives of the current MFR’. This was done on 13 January 2000.

4.253. The note of the meeting ended with the statement that ‘DSS were proposing to recommend to [Ministers] that no changes are made to the MFR assumptions until the outcome of the MFR review is known and the review of contracted-out rebates has been carried out’. In a later tripartite meeting, it was suggested – in relation to the statement of the purpose of the MFR to be included in the published version of the MFR review – that the phrase ‘reasonable expectation’ should be avoided, as it had a particular meaning in the context of the regulation of life insurance.

4.254. On 28 January 2000, the actuarial profession sent its final version of the progress update on the MFR review to DSS (see above).

4.255. On 31 January 2000, a submission was made to Jeff Rooker, the then Pensions Minister, by DSS officials. This set out recent developments in the MFR review and it informed the Minister that the recently received progress report ‘reiterates the actuarial profession’s view that the public’s expectation of the MFR is that it is a solvency test (which it is not) and that in the
light of this expectation there should be a much clearer disclosure of the true solvency position.

4.256. When dealing with the proposed short-term changes to the MFR that had been proposed by the actuarial profession, the submission said:

There are strong arguments for incorporating these changes to the MFR... These changes are technical amendments and are simply restoring the strength of the MFR level to the level intended when the requirement was first introduced. Though they will not come as a surprise to occupational pension schemes, there are financial implications.

4.257. The submission then set these out. It continued that ‘if we introduce these changes to the MFR we are likely to come under pressure to similarly change the assumptions used in the calculations of rebates which would be to make them more expensive to government. We do not have Treasury agreement to this’.

4.258. After saying that it would seem sensible to consider any MFR changes together with the outcome of their review of contracted-out rebates, the submission then concluded with a recommendation that ‘we do not feel that now is the time to be introducing these short-term changes’ and sought the Minister’s approval for such a decision.

4.259. On 9 February 2000, the Minister’s Private Secretary wrote a minute that set out the Minister’s agreement to the recommendation that the short-term changes to the MFR basis proposed by the actuarial profession should not be made at that time.

Announcement of MFR review timetable

4.260. On 10 February 2000 in an answer to a question from Frank Field MP, the then Secretary of State, Alistair Darling, announced that the actuarial profession’s review of the MFR would be published ‘in spring this year’.

Stakeholder meetings

4.261. On 13 March 2000, a meeting – one of a series with key stakeholders – was held between officials of the Treasury, DSS and GAD and the TUC’s pensions officer. A representative of the actuarial profession also attended the meeting. The note of the meeting recorded the view of the actuary that he was ‘concerned about people’s lack of understanding of what the MFR could be expected to deliver’. The note continued:

He was concerned that companies could go to the wall, but schemes would be unable to pay benefits in full, when the inference was that they would be able to do so. He felt there should be more clarity in communication on the strength of the pensions promise. [The TUC officer] agreed, saying that misunderstanding of what the MFR represents does give people false expectations. [The actuary] added that before the Pensions Act responded to the Maxwell affair, schemes could in effect wind up and walk away.

4.262. The note recorded the response of the GAD official, who:

...pointed out that 100% MFR might, for example, buy only 70% of benefits. There was a trade-off here of costs as against security. He added that the CBI would not be happy with a MFR pitched at a level to produce 100% benefits (full solvency) – employers would just walk away from schemes.

4.263. On 22 March 2000, a similar meeting was held with the Confederation of British Industry. The note of the meeting recorded the view of a CBI representative that ‘it was not really clear what the MFR was intended to achieve and, to the extent that it was trying to achieve something, the current MFR was not doing so’. The CBI also acknowledged that a real solvency test would not be acceptable to most employers.
**Parliamentary debate**

4.264. On 3 April 2000, in a parliamentary debate on the Child Support, Pensions and Social Security Bill, Jeff Rooker, the then Pensions Minister, said:

> A number of measures were introduced in the 1995 Act with the aim of promoting security for members of pension schemes, including the minimum funding requirement. It is important to protect members and the benefits that they are promised. There can be no objection to that.

4.265. The Minister continued:

> The minimum funding requirement is not a guarantee of solvency. I freely admit that as a lay person I had thought it was. In the past eight months, since I have been at the Department of Social Security, I have looked at the issue in more detail. The lay person can get a false impression from the minimum funding requirement. It is not intended to force employers to contribute at a higher rate than is needed in the long term to meet the benefits promised.

4.266. He went on:

> The minimum funding requirement should lessen the risk that a scheme is underfunded through, for example, an over-extended contributions holiday... the MFR is an on-going requirement on schemes to monitor their funding position and to have in place a contributions plan to ensure that the appropriate funding level is maintained.

4.267. The Minister then stated:

> We are aware of the importance of protecting members’ rights. That is the bottom line. If we cannot do that, they have no-one else to look to. Where there are gaps in legislation we must block them. There is no evidence of major difficulties. Reviews are going on and we will report the results to the House as early as we possibly can.

**Research by the FSA**

4.268. In April 2000, the FSA published research it had commissioned in a report called ‘Better Informed Consumers’.

4.269. One of the findings of the research was that:

> Most respondents in the... survey who had taken out or considered a [financial] product in the last five years were not dissatisfied with the information available, claimed that they did not want more information and were confident that they had all the information to make the right choice of product. The fact that so many consumers had confidence in recent financial decisions, despite the relatively low levels of shopping around reported, suggests that many would benefit from further information but are unaware that they need it. Therefore, a major task for the FSA is getting consumers to recognise that they have information needs in the first place.

4.270. In urging caution about their findings, the report’s authors suggested that there were problems with information and advice that were common across all groups. These were that consumers did not know what products were available or appropriate for their needs, that they were often overwhelmed and confused by information in leaflets, that they did not always understand the jargon and terminology used in the information or advice that they did receive, that they were often shocked by the ‘small print’ after having taken out a financial product, and that they were unaware of how to access comparative information.

4.271. The report went on to say that only 7% of the participants in their survey had mentioned information from a financial services regulator as a preferred source of information about financial products. However, four out of five respondents were aware that the FSA was able to provide
generic advice and 45% (erroneously) believed that it was part of the FSA’s role to give individuals specific financial advice.

4.272. The report concluded by suggesting that the FSA capitalise on a high level of trust among consumers, a common view that independent advice was important, and that people were highly interested in the consumer services provided by the FSA – by using outreach (in the form of booklets, a helpline, the use of broadcasting and press opportunities, the FSA website, financial education course and public meetings) to increase the level of general financial awareness and knowledge.

**Cabinet Office report**

4.273. Also in April 2000, the Performance and Innovation Unit of the Cabinet Office published a report, with a Foreword by the Prime Minister, entitled ‘winning the generation game’. The focus of this report was on ‘improving opportunities for people aged 50-65 in work and community activity’.

4.274. In a section on occupational pensions, the report suggested that such opportunities were sometimes distorted in relation to work-based pension schemes and that this could be remedied by improvements to transparency, information, flexibility and incentives to stay in work.

4.275. It continued:

> More transparent arrangements will help improve information. Alone, however, they are not sufficient for all parties to make fully-informed decisions. Pensions suffer from being complex, often thought of as far off, and people tend to place current consumption high above saving for future consumption. DSS are already pursuing an agenda for improving pension information.

4.276. After listing recent initiatives by DSS that formed part of this agenda, the report went on to suggest that the Government should promote information about how much an individual would need by way of their pension pot if they wanted to retire with a certain level of income – and that DSS should try to develop ‘extra information’ to make the content of the information required to be provided by schemes to their members ‘even more understandable’.

**The actuarial profession’s review of the MFR**

4.277. On 1 May 2000, the actuarial profession submitted a report by the Pensions Board of the Faculty and Institute of Actuaries to the Secretary of State for Social Security, entitled ‘Review of the Minimum Funding Requirement’. The review appears to have been informed by the earlier work of the professional working party (see above).

4.278. The terms of reference for the review, which had been determined by DSS, first set out the Government’s policy intention as regards the MFR.

4.279. This stipulated that the MFR was intended to be:

> ...a benchmark funding level for salary related occupational pension schemes to protect members’ accrued rights in the event of the sponsoring employer becoming insolvent... [which would provide] protection at a level to enable pensions in payment to continue in full (excluding future discretionary increases) and give non pensioners a reasonable expectation of receiving benefits at a level that would have been paid if they had become deferred members and the scheme continued as an ongoing scheme... [This] benchmark funding level should be derived from an objective test which is independent of the circumstances of each scheme (except for gilt matched schemes). In most circumstances, meeting MFR should not require, in the long term, contributions which exceed the contributions
produced by ongoing valuations for a scheme which is fully funded on the ongoing basis on reasonably prudent actuarial assumptions.

4.280. A ‘reasonable expectation’ was defined as meaning ‘an “even chance” on transfer to an appropriate alternative pensions vehicle’ and the terms of reference then set out the detailed issues to be covered by the profession as part of their review.

4.281. After dealing with concerns that the then current MFR test was arbitrary or perverse in its effects, the report, in a section headed ‘solvency and funding’, discussed another concern – ‘that the MFR test is an insufficient measure of the cost of buying out members’ benefits and is therefore too weak in relation to members’ security’.

4.282. The report’s analysis started by saying:...it was inherent in the design of the original MFR test that it is not a “solvency test”. This is clearly reflected in the terms of reference for the current review, which refer to giving non pensioners a “reasonable expectation” of receiving their benefits. The MFR test is not designed to “guarantee” that members will receive their promised benefits. Moreover, the MFR test does not cover any benefits provided on a discretionary basis.

The general consequence of this is that, if a scheme winds up with assets equal to 100% of its liabilities on the MFR, the money available after securing immediate annuities for the retired members will only be sufficient to secure deferred annuities for the remaining members at less than 100% of their accrued benefits.

We have a particular concern that this is not understood by scheme members, trustees and employers, who believe that the benefits from a scheme which meets the MFR are fully secure.

4.283. The report continued:

Looking at the present situation, however, the picture is of even greater concern. When the current MFR test was originally established, it was designed so that the buy out costs for pensions in payment would be broadly equal to the value of the liabilities for those benefits under the MFR test. However, under current circumstances the buy out costs for pensions in payment are of the order of 10% to 20% higher than the MFR liabilities.

4.284. The report explained that this was due to recent improvements in pensioner mortality and that the MFR test did not take into account a proper allowance in a lower inflationary environment for pension increases which were subject to minimum and/or maximum percentage increases each year.

4.285. The report also said that, for members not yet retired, the buy out costs would also be greater than the MFR liabilities because the values of annuities would differ because of the factors outlined above and also because the MFR had been designed to deliver only a ‘reasonable expectation’ (rather than a guarantee) that benefits for non-pensioners would be secured.

4.286. Using a model scheme that was funded to 100% on the MFR, the report then showed that non-pensioners’ benefits in that scheme would only be 69% secure on wind-up and concluded that, if a scheme were only funded to the MFR level, members not yet retired would routinely receive ‘significantly less than 100% of their accrued benefits’ and that the shortfalls below 100% ‘could vary quite sharply over time’.

4.287. The report then went on to analyse the MFR and alternatives (including changed bases for MFR calculation). In section 4.7.1 of the report, it was said that the then current MFR test was:
...therefore a “hybrid” test, being a full security test for pensioners but a much weaker, funding test for non pensioners. It is our view that the implications of this are not understood by members of schemes, who will almost inevitably assume that if they know their scheme is at least 100% funded on the statutory MFR test, then their benefits must be fully secure and protected. We strongly recommend that the new MFR test should be coupled with much clearer disclosure of the real position regarding the security of members’ benefits in the event of the scheme winding up, for each class of member.

It is therefore a key conclusion of the review that there should be 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 enhanced disclosure 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.

We believe it will be necessary to create a better understanding amongst members of the public of the issues involved. In particular, it will be desirable to gain acceptance that an investment strategy that attempts to eliminate all risks is unlikely to be the most appropriate for long term savings. The uncertainties of the future need to be explained, together with the steps being taken to mitigate (but not eliminate entirely) those risks. The actuarial profession is keen to work with Government, employers and pensions organisations to promote a greater awareness and understanding of these issues among scheme members.

4.288. In proposing a basis for disclosure, the report continued:

As mentioned above, it is important that members are not misled into thinking that an MFR level of 100% will ensure that their benefits are fully secured on winding up, since the MFR test is not designed to deliver this. We therefore distinguish between a “security level”, which should be disclosed to members, and the minimum funding requirement, which determines the controls placed on schemes to underpin the extent to which they are required to meet the full security standard. We recommend that the scheme actuary should be required to certify the level of scheme security, broken down by different liability categories, at the date of the triennial MFR valuation. This information should be disclosed to scheme members in the trustees’ annual reports.

4.289. The report then considered the ‘debt on the employer’ provisions – relevant to situations in which schemes wound up with assets below the MFR level – and also issues related to the calculation of cash equivalent transfer values and other technical matters. It proposed a number of longer-term changes to the MFR, including longer deficit correction periods and the abolition of the need for annual recertification; a move in investments towards the use of a composite index of gilts and corporate bonds to ameliorate distortions in the gilts markets; and the removal of the equity market value adjustment as part of the MFR test.

4.290. In section 5 of the report, three proposals for interim changes to the MFR basis were set out. These were later to be set out in an annex to the Government’s consultation document (see below).

4.291. Section 6 of the report discussed the framework in which the current – and any revised – MFR operated.

4.292. In dealing again with the purpose of the MFR and the degree of security it gave to members’ pension rights, the report said:

...the security for members’ benefits rests partly on the assets built up in their fund, which the
MFR legislation attempts to measure and control, and partly on the continuing financial strength of the employer who underwrites the eventual cost of the benefits promised to his employees. The point at which members’ security becomes of vital importance is when the scheme is wound up, particularly if this event is caused by the insolvency of the employer. It is our contention that there may be a widespread misplaced public perception that a scheme which is 100% funded on the MFR test would provide full security for members’ benefits.

Our proposals for clearer disclosure of the true position on security of benefits in the event of the scheme winding up should lead to a greater understanding of these issues...

4.293. The report then went on to consider the relative merits of three options for reform – the establishment of a central discontinuance fund, requiring schemes to take out solvency insurance, and a redefinition of members’ benefits on winding up to become their shares of the available assets.

Preparations for publication of MFR review

4.294. On 16 May 2000, DWP officials made a submission to Jeff Rooker, the then Pensions Minister, that provided briefing on the actuarial profession’s report and set out handling issues. After noting that one of the proposals would be the ‘disclosure to members’ of the degree of security they could expect from the MFR which would ‘highlight the fact that the objectives of the MFR mean that non-pensioners only have a “reasonable expectation” of achieving their benefits’, the submission then went on to discuss the key points to be considered.

4.295. In a section entitled ‘proposals for interim changes’, the submission noted that such changes were ‘designed to restore its strength to the level intended when the requirement was first introduced’ as ‘the MFR test is currently weaker than originally intended’. In a later paper, these changes were described as technical measures to take into account increased longevity, make allowance in the valuation of pension increases for the possibility that price levels may fall, and to change the equity market value adjustment factor to reflect recent changes in corporate activity.

Parliamentary question on MFR and venture capital

4.296. On 7 June 2000, the then Secretary of State, Alistair Darling, answered a parliamentary question from Claire Curtis-Thomas MP, who had asked what assessment had been made of the MFR with reference to the use of venture capital.

4.297. He replied:

The MFR does not prescribe how pension funds should invest their assets. Investment practice is a matter for pension schemes. The MFR is intended to provide a reasonable level of security for members in the event of the employer becoming insolvent and requires defined benefit schemes to hold a minimum level of assets to meet their liabilities, valued according to a prescribed methodology.

Child Support, Pensions and Social Security Act 2000


4.299. This part of the Act:

(i) provided for procedures to ensure that the trustee boards of all schemes were constituted with at least one-third of their members having been nominated by scheme members;
(ii) gave powers to OPRA to make their register of disqualified trustees available to the public;

(iii) allowed OPRA to monitor schemes which were in the process of winding-up, thus implementing some of the proposals contained in the winding-up consultation (see above);

(iv) extended the remit of the Pensions Ombudsman;

(v) enabled Regulations to be laid at a later date which would require money purchase schemes to provide members with a statement of their likely future pension entitlement; and

(vi) changed the way in which schemes discharged contracted-out pension rights, effected scheme transfers, and dealt with other technical matters.

4.300. In relation to the measures related to the winding-up of schemes, the Explanatory Notes to the Bill said:

The measures aim to ensure that a trustee is in place following the insolvency of the employer so that decisions can be made about the future of the scheme. Where winding-up has started, trustees or managers will be required to make reports to OPRA if winding-up is not completed within a specified period of time and OPRA will be able to direct action to speed the process along. OPRA will also be able to modify scheme rules where they need to be changed to allow winding-up to proceed.

Report of the Pension Forecasting Advisory Group

4.301. In the meantime, in July 2000 the Pension Forecasting Advisory Group published a report, entitled 'Planning Your Future'. The Group had been formed following a Ministerial announcement on 22 July 1999 with the remit of considering how best to implement the Government’s proposals for combined state and non-state pension forecasting (see above).

4.302. Two of its recommendations were that, first, DSS should supply a general leaflet about state pension provision which would be used by employers and pension providers to provide an introduction to the combined forecasting service and to explain the state element of an individual’s forecast pension entitlement. Secondly, while noting that employers and pension providers had a key role to play in providing further information to individuals, the Group recommended that DSS should look at mechanisms for ensuring that any advice given was made readily available, kept up to date, and explained in plain language.

4.303. The Group also recommended that DSS, employers and pension providers consider together what warnings might be needed to be provided with the combined forecasts.

Final preparations for publication of MFR review

4.304. On 31 August 2000, as part of the final preparations for the publication of the actuarial profession’s report and the Government consultation document published in parallel to it, the Minister’s Private Secretary recorded the Pensions Minister’s view that the interim change in relation to the assumptions about future pension increases should only be an option for consultation, with no commitment that the Government would actually implement it. The reason given for this view was that there had been no ‘serious evidence/economic forecasts indicating that there will be a fall in prices over the next 10-20 years’. His support for the other proposed interim changes to the MFR was also recorded in this note.
Security for Occupational Pensions – the MFR consultation


4.306. Paragraphs 3 to 6 of the consultation document explained:

To provide for their liabilities, defined benefit occupational pension schemes build up funds. These are subject to the Minimum Funding Requirement introduced under the Pensions Act 1995. Schemes whose assets fall below the minimum set by the MFR test have to make up the shortfall within prescribed time periods. However, the MFR does not provide a guarantee that, in the event of an employer becoming insolvent, its pension scheme members’ rights will be honoured in full. And there have been indications that the MFR also adversely influences the investment decisions of scheme managers. This could damage the longer term prospects for such schemes, which remain an important way of providing for retirement. Further to that, in the last budget the Chancellor announced that he was asking Paul Myners [then chairman of Gartmore Investment Management and subsequently chairman of Marks and Spencer] to review the factors that influence institutional investment decisions. Responses to his review, for example from the National Association of Pension Funds, suggest that the MFR has distorted investment decisions.

In March 1999 the Department of Social Security commissioned a report on the MFR from the Faculty and Institute of Actuaries, which is published alongside this consultation document. It contains proposals for reform and identifies a number of wider issues concerning the security and costs of defined benefit pensions. But it also suggests that the current MFR may not be the most appropriate approach for the future. This document therefore seeks to explore these wider issues with a view to achieving security for defined benefit pensions from well performing schemes. A number of options are put forward and the Government welcomes comments on the alternatives specifically discussed as well as other suggestions.

Paul Myners has also been asked for his views on the MFR and the possible alternatives as part of the consultation process. He will report at the time of the Pre-Budget Report.

4.307. Following the introduction, the document had seven sections and a conclusion. These were entitled ‘the importance of occupational pensions’; ‘existing protection for scheme members’; ‘the MFR review’; ‘how the current MFR works’; ‘the Actuaries’ report’; ‘a wider debate’; ‘options for protecting pension rights’; and ‘updating the current MFR’.

4.308. The document noted the importance of occupational pension provision within the UK and said that the Government ‘wants to help people understand their pension rights and appreciate the value of saving for pensions’.

4.309. In relation to the security of current final salary schemes, it said that ‘there is no intrinsic guarantee that the accumulated funds will be able to deliver members’ pension rights’. The documents then stated that the intention behind the MFR was:

...to provide protection for pensioners and other scheme members’ rights by setting a benchmark for the acceptable level for the scheme’s assets. With this floor in place, there is a reasonable chance that if the employer becomes insolvent, the pension scheme’s assets will be able to meet the cost of paying out pensions for those already
retired and provide for other scheme members’ rights. It is not a solvency test as such and it is sometimes misunderstood to offer a more powerful guarantee about payment of pension rights than it actually delivers when a scheme winds up.

The previous Government set the objectives for this MFR test. The valuation method and assumptions for the MFR were then developed by the Faculty and Institute of Actuaries in 1995/1996 to meet the objectives set by Government.

4.310. The document went on to explain the context in which the actuarial review of the MFR had been undertaken and that the consultation process was intended to launch a wide ranging discussion on the issues that had been identified within the actuaries’ report.

4.311. It then set out what the MFR had been designed to deliver – namely, regardless of whether the sponsoring employer was solvent, that existing pensioners would have their pensions paid in full and non-pensioners would have ‘a reasonable expectation of receiving the value of their pension rights when they come to retire’.

4.312. The document went on:

...the amount of reassurance the MFR can deliver is commonly misunderstood to be a good deal greater than it really is. Some people think the MFR test amounts to a full guarantee of scheme members’ pension rights. It is not a solvency test. A funding requirement that gave full protection to members when their scheme ceased would lead to significantly higher costs than is the case under the MFR.

4.313. It also reaffirmed that the Government’s objective was to ‘protect the immediate interests of pensioners and other scheme members without damaging the longer-term prospects for current and future members’.

4.314. The document recognised that the actuarial profession, in its review, had discussed ‘the case for bringing home to scheme members the scale of protection which the MFR can deliver, perhaps by disclosing to scheme members what benefits could be delivered should the scheme wind up’.

4.315. The Government explained that it wanted to consider a wider range of options for reform than those set out in the actuarial profession’s report, including prudential supervision and either compulsory mutual or compulsory commercial insurance.

4.316. In relation to the actuarial profession’s recommendation for disclosure to scheme members, paragraph 56 of the report stated:

One of the key recommendations in the Actuaries’ report is for disclosure to members about the security of their benefits. Their concerns stem from the fact that the MFR is not a solvency test but that this is not always fully understood by members. The report recommends that there should be disclosure to members of, broadly, the extent to which their benefits could be secured by means of annuity purchase if the scheme were to wind up. This approach could be considered whatever policy is adopted. The Government would welcome views on this idea and how it might be achieved.

4.317. In the list of specific questions on which responses were sought by DSS, question 13 asked ‘are there any reasons why there should not be disclosure to members of the scheme’s solvency position and of what this might mean should their scheme cease? How might such information be best communicated to members?’

4.318. The press notice which accompanied the publication of the consultation, which was issued
under the title ‘Darling launches consultation paper on pension protection’, quoted the then Secretary of State as saying:

*This government is determined to protect the long-term security of pensioners and other pension scheme members. In the light of [the actuaries’ review] it is right to look at whether the current MFR is the best approach... It is therefore sensible to explore whether there is a more effective or reliable way of protecting scheme members’ rights.*

4.319 Paragraphs 3 and 4 of annex one to the press notice explained that:

*The MFR is intended to provide a reasonable level of security for members in the event of the employer becoming insolvent and no further funds being available to pay into the scheme. The underlying objectives of the MFR were decided by Government; the valuation method to meet the objectives was devised by the Pensions Board of the Faculty and Institute of Actuaries.*

*The objective of the MFR is that a scheme fully funded according to its requirements would, if the employer became insolvent, protect fully pensions already in payment, and provide younger members with a transfer value that would give them a reasonable expectation of replicating scheme benefits if they transferred to another pensions vehicle...*

4.320 Paragraph 14 of the annex set out the proposed interim changes to then current MFR arrangements that had been recommended by the actuarial profession and which the Government said it was considering. The notice said that these included:

*...adjusting the way in which MFR liabilities are assessed to reflect:*

  * an extra two years longevity;*

  * for pension increases – that price levels may fall;*

  * changing patterns of corporate activity; and*

  * generally lower market dividend yields since the current scheme was introduced.*

4.321 Responses to the consultation were sought by 31 January 2001. According to a subsequent parliamentary answer, 73 responses had been received by 7 February 2001.

4.322 OPRA’s response to the consultation was submitted in January 2001 and in it OPRA commented:

*Risk is not generally understood by members of defined-benefit schemes, who are exposed to a different form of risk – that of the assets of the scheme on termination being insufficient to deliver the accrued benefits. These different risks need to be explained clearly to members.*

4.323 It continued:

*...taken as a whole, the provisions of the Pensions Act 1995 may give scheme members grounds to believe that they have more security than they actually have. As with all forms of investment, membership of [defined benefit] schemes carries a degree of risk. It is unacceptable for scheme members not to have access to a clear and simple explanation, by category of member, of the level of security afforded by the current MFR. There is a parallel here with the ‘Key Features’ documents required in relation to certain financial products. Scheme members should have access to a realistic assessment of the extent to which the pension rights which they have built up are secure. On balance, it is better that members are provided with such a realistic assessment, even if it does give rise to member concerns.*
4.324. In response to question 13, OPRA said:

We very much support the disclosure to members of the scheme’s solvency position… This might usefully be incorporated in the scheme’s annual report or in the annual benefit statement issued to members. In our view, it would be critical that the solvency position should be explained in a clear and straightforward way and that the solvency position should be indicated separately for each membership category. This explanation should also seek to address concerns that may be raised in members’ minds about the security of their accrued rights, if the scheme was not fully “solvent”. Indeed, simply disclosing the scheme’s solvency position to members may not achieve much if members are unable to exert pressure on the sponsoring employer to improve the scheme’s financial position or if the upshot is that members leave the scheme. If handled correctly, the disclosure to members of the scheme’s solvency position could help members to understand the nature and costs of the pension promises made to them.

4.325. The actuarial profession’s response to the consultation was also submitted in January 2001. In appendix 6 to their response, the Faculty and Institute of Actuaries dealt with the proposed interim changes to the MFR basis.

4.326. In relation to the proposed change to the equity market value adjustment, the actuaries said:

We have performed further analysis of the changes to the levels of equity dividends and market value adjustments over the period since May 2000 [when the interim changes were first proposed] and confirm that a reduction to 3.0% would remain appropriate at the current time but this should be re-examined at the time any change is put forward, as the trend has continued and a different figure may by supportable on the basis of subsequent movements.

4.327. In the meantime, on 28 September 2000, DSS published a report of research it had undertaken into pension scheme trustees’ experience of their role. The report was entitled ‘the changing role of occupational pension scheme trustees’.

4.328. Among the research’s key findings was one that trustees’ knowledge of their duties varied, with those in smaller schemes appearing to be much less knowledgeable and heavily dependent on advice.

Revised Actuarial Guidance Note

4.329. On 1 December 2000, the actuarial profession issued a revised version (1.5) of their guidance note, ‘Retirement Benefit Schemes – Minimum Funding Requirement’. These made minor technical changes to professional guidance which are not of relevance to the heads of complaint.

Parliamentary question on member protection

4.330. On 26 February 2001 in response to a question from Desmond Browne MP, who had asked what provisions were in place to protect employees whose pensions had been affected detrimentally by the insolvency of their employer, Jeff Rooker, the then Pensions Minister, replied that:

...the Pensions Act 1995 brought in a number of measures to promote security for members of pension schemes, including the Minimum Funding Requirement which requires defined benefit schemes to hold a minimum level of assets to meet their liabilities.

In the event of a sponsoring employer’s insolvency, the legislation requires that an independent trustee must be appointed. The role of the independent trustee is to ensure that the interests of the members are represented in insolvency proceedings and to make any
necessary decisions about winding up the scheme. If on wind up the scheme is not fully funded on a Minimum Funding Requirement basis, the amount outstanding becomes a debt on the employer and the trustee must pursue recovery of this amount.

Where the scheme finds itself in deficit due to fraud, compensation may be payable under the Pensions Compensation Scheme. Unpaid employer and employee contributions may be payable from the National Insurance fund through the Department of Trade and Industry’s Redundancy Payments Service.

Westminster Hall debate on the Basford Group Pension Scheme


4.332. The then Pensions Minister, Jeff Rooker, in answering the debate, said:

When I started to get to grips with the minimum funding requirement, I mistook it as a solvency test. It may appear that way to a lay person, but there is no doubt that it is not. Pension schemes must be adequately funded to cover their liabilities. The 1995 Act introduced the MFR, which requires defined benefit schemes – schemes based on final salary – to hold a minimum level of assets to meet their liabilities.

4.333. He continued:

We recognise that matters have changed since the minimum funding requirement was introduced. It came into force in 1997. As my hon. Friend acknowledged, many of the issues that affected his constituents are not covered by the 1995 Act, which had not come fully into force at that time. The Government consulted on the future of the minimum funding requirement and are currently studying the responses.

4.334. The Minister concluded by saying:

Coupled with that was the Myners review, set up by my right hon. Friend the Chancellor of the Exchequer. Given that he is about to make a major speech in the House in the not too distant future, he may or may not have something to say about that. The report has been received, and the consultation on the minimum funding requirement concluded at the end of January.

We have been considering the responses to that consultation, because we must make an early statement about whether we will do nothing or do something, so that people know what is happening.

The Myners Report

4.335. The Government published Paul Myners’ report, ‘Institutional Investment in the United Kingdom: A Review’, on 6 March 2001. His review had been commissioned by the Chancellor of the Exchequer at the time of the 2000 Budget to consider whether there were factors that were distorting the investment decision-making of financial institutions – in the light of the Government’s concern that such institutions were investing too much on quoted equities and gilts and too little in small and medium-sized enterprises and other smaller companies because of industry-standard investment patterns.

4.336. As noted above, Myners had been asked in September 2000 to include an analysis of the MFR in his review and he had submitted his interim views on the MFR to the above consultation on the MFR in November 2000.

4.337. In his covering letter to the Chancellor of the Exchequer, Myners said:

Diagnosis of... problems is easier than cure. I do make a number of suggestions for legislative and tax change. I propose that trustees should, as in the US, have a legal requirement to be familiar with the issues when they take investment
decisions. I propose replacing the Minimum Funding Requirement, which distorts investment and fails to protect scheme members, with a long-term approach based on disclosure and openness instead of an artificial uniform yardstick.

But I do not suggest that these alone are enough. Further change is needed. My strong preference, however, is for the industry – if it is willing – to drive change forward itself. Legislation, though it might in the end prove necessary, is likely to be a blunt instrument to tackle the kinds of problem I have described.

4.338. In paragraphs 10 and 11 of the summary of his report, Myners explained:

Most occupational pensions are organised on a trust basis, with a board of trustees responsible for determining how their assets are invested. As a survey conducted for the review confirms, many trustees are not especially expert in investment:

- 62 per cent of trustees have no professional qualifications in finance or investment;
- 77 per cent of trustees have no in-house professionals to assist them;
- more than 50 per cent of trustees received less than three days’ training when they became trustees;
- 44 per cent of trustees have not attended any courses since their initial 12 months of trusteeship; and
- 49 per cent of trustees spend three hours or fewer preparing for pension investment matters.

This is not true for all pension schemes, however. Larger schemes are more likely to have the resources to recruit and train more knowledgeable trustees, and the use of professional trustees has grown in recent years. But generally speaking, pension fund trustees, whether of defined benefit or defined contribution schemes, are able to bring limited time and expertise to the investment decision-making aspects of their work.

4.339. After dealing with institutional investment and the context for investment decision-making, the roles of trustees, actuaries, investment consultants and fund managers, the position in relation to defined contribution pension schemes, and pension fund surpluses, chapter 8 of the report dealt with the MFR.

4.340. This chapter first set out the background to the MFR, saying that it was:

...designed to underpin the employer’s commitment to support a defined benefit scheme it sponsors, so that in the event of the scheme having to cease, whether the employer is insolvent or not, scheme members already retired can expect their pensions to be paid in full, and scheme members who are not yet retired have a ‘reasonable expectation’ of receiving the value of their pension rights when they come to retire.

4.341. After describing in broad outline how the MFR worked, it continued:

Providing security for members of defined benefit pension schemes is an essential objective for any responsibly run pensions system. While there is no reason to doubt that the overwhelming majority of pension funds are run both properly and effectively, it is essential to have effective safeguards to ensure that members of defined benefit pension schemes can have confidence in the system.

4.342. The report then discussed the effects of the MFR on institutional investment decision-making. On turning to the issue of member risk, the report continued:

The MFR applies only to defined benefit pension schemes, not defined contribution schemes,
because members of defined contribution and defined benefit schemes are subject to very different kinds of risk. Defined contribution members bear the investment risk of the contributions. Defined benefit members bear no risk at all unless the employer becomes insolvent; if this does occur, then they bear a mixture of investment risk and an additional ‘trustee risk’ – that the trustees could have incompetently or dishonestly managed the fund and left it underfunded.

4.343. Myners’ critique of the MFR was that:

Most fundamentally... a funding standard such as the MFR, by its nature, does not address properly the question of protecting defined benefit scheme members. The MFR is concerned to prevent a situation where a defined benefit pension fund is insufficiently funded and then, because of employer insolvency, is unable to meet its obligations. Yet to determine whether such a situation is likely to arise requires one to take a view of what the future investment returns of the fund will be. Whether or not the pension fund will in practice be able to pay its pensions will depend on future investment returns. A true system of protection for beneficiaries should focus on the issue of the reasonableness of that assumed return.

This the MFR fails to do. Rather, it seeks to establish whether a pension fund is ‘under-funded’ or not using assumptions which are:

- the same for all funds, albeit with adjustment factors for maturity;
- fixed by legislation; and
- treated as a technical question, for resolution by the actuarial profession.

None of these points is justified. The assumptions should differ with the maturity of the scheme, the strength of its sponsor, and the views of the trustees on a suitable investment strategy. They should be free to change with changing circumstances. They are not an obscure technical question, but the very heart of the question of whether the fund is adequately funded or not.

It follows that the MFR does not provide the protection that many assume it does, as the standard assumptions it makes may prove to be wrong. Indeed, its effects could well be counterproductive to the extent that it gives trustees a spurious sense of certainty about funding levels and weakens the fiduciary responsibility that should be at the heart of protection for members of defined benefit schemes.

4.344. The report then set out a proposed alternative to the MFR – a scheme-specific funding standard that would seek to afford effective protection for members of defined benefit pension schemes through appropriate investment strategies and would be designed to enable the differences between smaller and larger schemes to be taken into account. Such a standard would be based on transparency and disclosure and schemes would be required to report publicly on the current financial state of their fund and on future funding plans.

4.345. Myners’ other recommendations, insofar as they are relevant to this report, were that:

(i) the level of compensation available for non-pensioner members of schemes who qualified for compensation should be increased from 90% of MFR liabilities to something closer to the cost of securing members’ accrued rights (or the amount of the loss, whichever were the lesser);

(ii) there should be a statutory requirement for funds to be placed in the custody of someone independent of the sponsoring employer; and
(iii) each defined benefit scheme should be required each year to set out in clear and straightforward language such matters as the current value of its assets and in what classes these assets were invested, the assumptions used by the scheme to value its liabilities, planned contribution schedules and asset allocations, and an explanation of the implications of economic volatility for the value of the assets of a scheme.

4.346. The chapter concluded by expressing concern that the then proposed EC Directive on the prudential supervision of occupational pension schemes, which had been published in draft on 11 October 2000, might, if adopted without amendment, have the effect of replicating some of the faults of the MFR.

The Government’s response to the MFR consultation and Myners


4.348. After explaining why the Government had rejected proposals for a central discontinuance fund, requirements for commercial insurance or compulsory mutual insurance, and prudential supervision, the document set out two models that had received significant support in earlier consultations: a common funding standard and a long-term, scheme-specific funding standard underpinned by a regime of transparency and disclosure, as had been recommended by Myners.

4.349. The Government explained that it had decided to reject the common funding standard approach, as it was:

...not satisfied that a practical regime can be devised which avoids the drawbacks affecting the current MFR. A common funding standard does not take into account the scheme’s specific circumstances and can therefore worsen protection. Assumptions that are right for one scheme are not necessarily right for another scheme. Further, the process of valuing liabilities on the basis of a common funding requirement inevitably leads to actuarial conventions driving and distorting investment, leading to increased costs. This option would be fundamentally no different to the current situation and is likely to damage the long-term future of defined benefit pensions or risk reducing the benefits that they provide. It does not provide the best protection for pensions and brings with it the risk of damaging consequences for investment like the current MFR.

4.350. The document explained that, instead, it would seek to implement the scheme-specific funding standard with additional measures to strengthen protection further. These included the placing of a statutory duty of care on scheme actuaries, stricter conditions on voluntary wind-up, and an extension to the fraud compensation scheme.

4.351. The document ended by noting that the Government’s proposals would require primary legislation to implement them but that, in the meantime, the Government would work with the pensions industry and other interested parties to develop proposals for legislation to be introduced when parliamentary time allowed.

4.352. It also announced that, as the MFR was to be abolished and as most of the respondents to the September 2000 consultation had not supported them, the Government had decided not to implement the proposed changes to the MFR that had been recommended by the actuarial profession in its May 2000 report.
4.353. Paragraph 33 of the document set this decision out thus:

Most of those who responded to the consultation document did not support the package of interim changes to the MFR and many commented that they should not be made if the MFR was to be replaced in the near future. The Government is proposing to replace the MFR and feels that it is not sensible to introduce these changes now.

4.354. The decision not to implement the recommendations for interim reform of the MFR included the proposal for disclosure to members of the risks to their pension rights should their scheme wind up without sufficient assets to meet its liabilities. However, it was said that what information would be required to be disclosed to scheme members would be considered as part of the discussions about the detail of the new legislation to be introduced in due course.

4.355. On the same day, the Chancellor of the Exchequer announced the proposed replacement of the MFR as part of the statement he made to the House to outline his economic and fiscal strategy report and Budget.

4.356. The press notice which accompanied the publication of the document quoted the then Secretary of State, Alistair Darling, as saying:

The Government is determined to protect the long-term security of pensioners and other pension scheme members in occupational pension schemes. It is clear that most people believe that the MFR does not provide effective protection and the Government therefore proposes a radically different approach.

4.357. OPRA confirmed subsequently, on 25 July 2001, that the MFR would continue to operate until the enactment and commencement of its replacement.

Commons debate on occupational pension schemes


4.359. He reiterated earlier concerns he had had about the placing in administration of a company in his constituency, whose pension scheme had subsequently gone into wind-up despite the fact that the company had had a contributions holiday not long before the relevant events.

4.360. He then continued to ask whether the Government would consider establishing a ‘pension protection fund so that the liabilities from pension schemes that are discontinued would pass to a mutual company that would protect the funds of affected pensioners?’ and also whether the Government would consider reform to prevent companies from taking contributions holidays.

4.361. The then Parliamentary Under-Secretary of State for Work and Pensions, Maria Eagle, replied to the debate. After expressing sympathy for those former employees of the company who had suffered ‘the double blow of not only losing their jobs and being reduced to statutory redundancy pay but also finding a hole in the pensions in a defined benefits scheme that they had every right to expect would provide them with a well known, fixed amount when they retired’, the Minister continued:

Pensions law is tremendously complex, and issues that might seem to hon. Members, outsiders and members of pension schemes to be relatively straightforward and simple can be devilishly complex because of the law and how the schemes work.
4.362. She went on to explain the role of the MFR thus:

One of the central features of the Pensions Act 1995 was the introduction of the minimum funding requirement. It was designed to promote security for scheme members. It requires defined benefit schemes to hold the minimum level of assets to meet their liabilities. The aim of the minimum funding requirement is to ensure that a scheme that is funded to at least the level of that requirement will, in the event of the employer becoming insolvent, be able to provide pensions. It is also intended to provide younger members with a fair value of their accrued rights, which they can then transfer to another occupational pension scheme, or to a personal pension...

It is right that measures should be in place to protect the interests of members of a scheme whose funding has gone wrong. If a scheme is not fully funded on a minimum funding requirement basis when it winds up – which has happened in this case – the outstanding amount becomes a debt on the employer, and the independent trustee is responsible for pursuing recovery. The debts amount to the sum required to bring the scheme back to full funding on the minimum funding requirement basis. That is all very well if the employer is solvent, but it does not help if the employer is insolvent, as in the case under discussion. The provisions will not guarantee that the money owing to the scheme can be recovered. They are directed a fairly long way down the list of creditors as are the other obligations that the firm may have had.

4.363. Ms Eagle ended by saying that the Government would consult on a pension protection fund (while noting that such an idea had in the past had little support in the industry) and that compulsory mutual insurance as suggested in the debate would be an option on which views would also be sought.

4.364. Further parliamentary debates on the subject matter of this investigation were held subsequently on 22 January 2002, on 2 July 2002, and on 23 October 2002.

A Guide to your Pension Options by DWP

4.365. DWP published a revised introductory 34-page guide in July 2001 called ‘a guide to your pension options’ (leaflet PM1 – first published in June 1998). Its introduction stated that ‘these guides can give you helpful information, but only you can make decisions about your pension’ (emphasis in original). The revisions to the guide had been made to take into account the introduction of stakeholder pensions and the other sections of the guide were identical to earlier editions.

4.366. After describing the main features of state pension provision, the guide went on to set out the main features of occupational, personal and stakeholder pensions, while referring the reader to other publications by DWP – including leaflets that dealt with occupational pensions – if they wished more information. The guide also signposted the reader to other sources of information, including the then Citizens Advice Bureau and the Pensions Advisory Service and also publications by the Inland Revenue and others by DWP.

4.367. Pages 14 to 16 of the guide dealt with occupational pensions. Under a section entitled ‘should I join my employer’s occupational pension scheme?’, the guide explained:

Most members of an occupational pension scheme will be better off when they retire than they would be if they did not join it. This is because most employers pay something towards an occupational pension on top of the payments you may have to make. Generally, this means you will get a bigger and better pension that you could get for the same money anywhere else.
4.368. It continued (with original emphasis):

*If your employer runs an occupational pension scheme, you should think carefully before you decide not to join it. 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 adviser) before you decide.*

4.369. The guide then said that if the reader wished to know more about how occupational pension schemes worked, they should ask for a copy of the DWP leaflet that dealt specifically with such schemes.

4.370. In a section called ‘what else do I need to think about?’, pages 24 to 28 of the guide set out ‘other things that could affect your pension’. It listed change to the state pension age for women, the effects of divorce, the new system of bereavement benefits, and the implications of living abroad.

**Letter from Actuarial profession**

4.371. On 5 September 2001, the Chairman of the Pensions Board of the actuarial profession wrote to the Head of Private Pensions at DWP to inform him that the actuarial profession proposed that an interim change – the lowering of the dividend yield in the equity market value adjustment – should be made prior to reform of the MFR. The Chairman said in his letter that:

> ...the lack of any dividend from companies such as [a big multinational] would indicate that some change should be made to the MVA factor which produces a weakening of the basis at the point it is changed. Note however that this is aimed at bringing its strength back to that originally intended rather than an actual weakening. On the other hand, improvements in longevity would indicate a strengthening of the basis.

4.372. He continued:

*The extent to which these two effects cancel each other out in terms of the total for the MFR liabilities will depend on the maturity of each particular scheme. We are of the view, however, that the overall position has changed sufficiently to require a lowering of the dividend yield in the MVA from 3.25% to 3%. If we had considered more detailed changes in the form of our earlier proposals we would now be proposing a larger change to the MVA factor, to something of the order of 2.75% rather than 3%. However, in order to keep the proposal simple and to take some account of the underlying need for a change to the mortality assumption, we are suggesting that a smaller change is made which implicitly can be taken as making some allowance for the mortality change.*

**Actuarial paper on post-MFR framework**

4.373. On 14 September 2001, the actuarial profession wrote to DWP to submit a paper it had prepared which set out the thoughts of the Institute and Faculty of Actuaries about the issues that would 'need to be addressed in the coming review of the framework to follow the MFR'.

4.374. In relation to ‘transparency and disclosure’, the actuarial profession said that:

*Solvency on winding up is not yet a required disclosure [to scheme members] and we would propose that an approved measure reflecting the solvency position of a scheme should be a requirement. We are also aware that this fuller and wider disclosure has the potential to cause some confusion to members but we are equally concerned that lack of disclosure may hide important information. To that end we encourage full disclosure with greater consumer education.*
Further consultation on the MFR


4.376. The then Secretary of State for Work and Pensions and the then Economic Secretary to the Treasury, in a joint Foreword to the document, explained that, since the publication of the Government’s proposals (see above), the Government had received comments and suggestions from interested parties as to what should be done in the period prior to the enactment of new legislation to give force to their proposals.

4.377. The Ministers announced the formation of a Consultation Panel to assist with reform of the MFR. This would include issues related to what should be disclosed to scheme members about the security of their pensions and the solvency position of their scheme.

4.378. Membership of the panel was drawn from the National Association of Pension Funds; the Association of British Insurers; the Faculty and Institute of Actuaries; the Association of Consulting Actuaries; the Association of Pension Lawyers; the Society of Pension Consultants; the Fund Managers’ Association; the Trades Union Congress; the Confederation of British Industry; the National Consumer Council; and the British Chambers of Commerce.

4.379. The terms of reference for the panel were to:

…assist in developing the detailed policy for legislation on the replacement for the MFR, in particular to:

(i) work through the detailed policy package and draft legislation to ensure that it is coherent and workable across a wide range of occupational pension schemes but does not have adverse effects on investment behaviour or have unintended effects; and

(ii) facilitate a two-way communication process between the policy makers and the pensions industry.

4.380. The document then set out the principal comments that had been received in relation to its longer term proposals and went on to set out the package of measures that it proposed should be introduced in the interim.

4.381. The interim reforms, which were described as being ‘a balanced package that is good both for members and for employers’, consisted of three main proposals.

4.382. The first measure involved extending the deficit correction period to 3 years for seriously under-funded schemes to reach 90% of the MFR funding level – and to 10 years for under-funded (including seriously under-funded) schemes to reach 100% of the MFR funding level. The document said:

This change modifies the current MFR rules in a way that is consistent with the Government’s proposals to replace the MFR with a long-term funding standard. It will allow schemes to fund and invest in a more optimal way and smooths out some of the short-term volatility associated with the current MFR regime.

4.383. The second measure removed the requirement for automatic annual recertification of schedules of contributions where a scheme’s last MFR valuation showed that the scheme was
fully funded on the MFR basis. The document explained:

*Again, this change is consistent with the Government’s proposals to move to a long-term funding standard. It takes the focus, for a fully funded scheme, from the short-term to a more long-term basis. Consideration is also being given to the addition of a requirement for an out of cycle valuation where it appears that there has been a significant change in the funding position of the scheme – by bringing into force regulation 11 of the current Minimum Funding Requirement Regulations. This would mean that, although annual checks are being removed for fully funded schemes, security would still be re-assessed should there be a significant change in the funding position.*

4.384. The third measure introduced stricter conditions on voluntary wind-up. The document said:

*The Government has said it will legislate to make it clear that employers must meet in full the accrued entitlements of scheme members as they fall due. And the proposed policy for the longer term is that the method of calculating the debt on the employer when a scheme winds-up should be strengthened by including:*

(i) the actual costs of winding-up the scheme;

(ii) the actual costs of annuities for pensioner members; and

(iii) cash-equivalent transfer values for non-pensioner members calculated on the new long-term funding basis.

4.385. The document then explained that the Government proposed to move towards the third policy outlined above in the period prior to the replacement of the MFR by immediate action to strengthen the debt on the employer provisions by using actual costs rather than the MFR basis, while continuing to use the MFR to calculate cash-equivalent transfer values.

4.386. Responses to the consultation were sought by 10 December 2001 and the proposed Regulations to give effect to the interim proposals were attached to the document in draft. According to a later parliamentary answer, 140 responses were received.

**GAD advice on actuarial profession’s proposal**

4.387. On 25 September 2001, following ‘discussions’ held with DWP officials, a chief actuary at GAD emailed DWP.

4.388. The purpose of the email was, at DWP’s request, to:

*...set out GAD’s views on the following matters:*

(a) does GAD consider that events in the financial markets since 11 September mean that there is a case for taking action to change the MFR regulations to extend the deficit correction period in advance of the planned date of March 2002?

(b) does GAD consider that the DWP should accede to the request from the actuarial profession that the MFR equity MVA should be amended, by replacing the assumed long-term dividend yield of 3.25\%\ with 3\%?

4.389. The chief actuary continued by explaining that it was GAD’s view, in relation to (a) above, that ‘the increased market volatility experienced since 11 September and anticipated in coming months would support taking early action to extend MFR deficit correction periods, given that Ministers have already indicated that this change will be implemented next spring following consultation’.

4.390. He then explained the work – described as ‘approximate calculations’ – that GAD had undertaken in support of this view and set out a number of scenarios to put this in context.
4.391. In relation to the request for advice marked (b) above, the chief actuary’s full advice on this specific request was as follows:

In our view, recent events – in and of themselves – do not undermine the thrust of the argument of the actuarial profession. Accordingly, GAD would agree that the change to the equity MVA proposed by the profession is justified as a simple change which adjusts the MFR to a level of protection consistent with that applying when the equity MVA was last adjusted in June 1998.

DWP response to actuarial profession


4.393. After having noted that wholesale reform of the MFR required primary legislation and that the Government was currently consulting on a number of proposals for shorter-term reform of the MFR, the letter stated:

Our view is that we need to take a considered and balanced view as to the next stage of reform of the MFR, and that we should not make piecemeal changes. As such we would propose to give full consideration to your suggestion alongside others which we receive as part of the current consultation on the interim package of measures. Whilst we note the arguments you have put forward for an immediate change to the equity MVA we do not believe that such a change should be made in isolation, but should be considered as part of a coherent and balanced package arising out of the current consultation.

Parliamentary questions on occupational pensions

4.394. On 8 November 2001, in response to a question from Professor Steve Webb MP, who had asked what plans the Government had to discuss trends in occupational pension provision with the pensions industry, the then Minister, Ian McCartney, replied that the Government regularly discussed these matters with the pensions industry. Those discussions included ‘the role that Government can play in supporting and encouraging pension provision’.

4.395. He continued:

The Government acknowledges the contribution that occupational pension schemes play in the provision of income in retirement and want to encourage continued employer involvement.

4.396. The Minister then went on to explain the Government’s proposals for pension reform.

4.397. In response to a further question from Stephen Hepburn MP on how DWP planned to ‘encourage private pensions provision’, the Minister replied:

This Government are committed to encourage private pension provision – through pension education, making saving pay, providing appropriate savings vehicles, and better regulation...

Our pension education campaign has been driving home the message that those who can afford to save have an obligation to do so.

4.398. Later, in response to another question, from Gillian Merron MP, the Minister confirmed on 29 January 2002 that MFR reform through the proposed new Regulations would not have retrospective effect.

OPRA announcement on MFR

4.399. Following speculation in the wake of the events in the US on 11 September 2001 about the effects of the stock market fall on pension schemes, OPRA made an announcement on 6 December 2001 to confirm that, contrary to such speculation, OPRA was not intending – nor did it have the power – to suspend the operation of the MFR.
4.400. After drawing attention to the fact that, under existing legislation, schemes could apply to OPRA for an extension to the normal time allowed for an ‘under-funded’ scheme to make up MFR shortfalls, the then Chairman of OPRA was quoted as saying:

*These applications are complex and involve difficult decisions for [OPRA] ... We may be presented with a case where payment of the required level of contributions could seriously damage the business. But we have to balance that against our assessment that such an employer, already in financial difficulty, is likely to be able to continue in business.*

Members of final salary schemes should be aware that their benefits are not guaranteed in the event that their employer becomes bankrupt, even if the scheme is funded to 100% on the MFR basis. Pensions in payment are usually protected, but those members who have not retired could get reduced benefits. We advise members to take an active interest in their scheme and to find out about its funding position.

**Consultation panel discussion on disclosure**

4.401. In the meantime, the Consultation Panel appointed on 18 September 2001 (see above) had met to discuss the disclosure of information to scheme members on 16 November 2001.

4.402. The record of that meeting reported that:

*A discussion then followed as to the importance of educating members of the risks involved in their defined benefit scheme. If the employer remained in existence there would be no problems but members should be made aware of what happens should their employer become insolvent. However, the point was made that there were a range of risks, only one of which was the insolvency of the employer. And that these risks must be set in context.*

4.403. The note continued:

*Even with these risks, a defined benefit scheme was less risky than a defined contribution scheme and that wind-up with an insolvent employer is rare and is only one of a range of risks. Disclosure of the winding-up position must not make people think this will happen – this must be set in context. It was pointed out that whenever you enter a contract you should know the exit terms. What happens in wind-up should be disclosed to members, that there must be ways of overcoming the fear of members being frightened by this information, that it should be possible for members to understand that this situation is rare, and that we should not assume that members will act in an ill-informed way if this information is disclosed to them.*

4.404. It went on:

*However, [one member] expressed the view that everything should not hang off the winding-up position. But that members should be given a reassurance that the standard being used by their scheme is reasonable and that their scheme is being looked after. Or if it is not meeting this standard, then members should be told how this is being fixed. What happens should the scheme wind-up should be a secondary piece of information. The emphasis should be that their security is an ongoing employer. [Another member], agreed but said that this does not explain the risks involved, one of which is insolvency.*

4.405. The Panel decided to establish a sub-group to specifically look at the issue of communication with scheme members. This sub-group met later on 16 May 2002. According to the note of this meeting:

*There was then a discussion but no overall conclusion about what type of information should be disclosed to members. How much emphasis should there be on short-term market*
conditions that may effect the security of member benefits? It was suggested that members could be made aware of the risks to the security of their benefits – such as the under performance of scheme investments. Information about risks sent to members needs to be balanced because the greatest risk to the security of their benefits is the employer going out of business.

A comment was made that it is not enough to tell members about investment returns and contributions because on its own this information could be misleading. There needs to be an appropriate balance between providing information that is too bland to be of use and disclosing information that is too technical to be properly understood. It was noted that currently the only automatic disclosure item in relation to scheme funding was the requirement to disclose non-payment of scheme contributions in certain circumstances.

Ministerial speech to NAPF conference
4.406. On 22 November 2001, the then Pensions Minister, Ian McCartney, delivered a keynote speech to the annual conference of the National Association of Pension Funds.
4.407. The press notice issued by DWP announcing that speech said that the Minister had emphasised the importance of stakeholder pensions but that 'just as important is educating people to help them make an informed decision'.
4.408. The press notice then quoted the Minister as saying:

It is crucial that we provide better information. People need to see in black and white just how much they may or may not have in retirement, so that, if appropriate, decisions to secure additional pensions are made in good time.

Submission to Minister on interim MFR reform
4.409. On 11 January 2002, Ministers had been invited to approve the actuarial profession's further recommendation, made on 5 September 2001 (see above), to reduce the equity market value adjustment factor from 3.25% to 3%.
4.410. This was to be part of a wider package of reform to the MFR, which included an extension of the deficit correction periods, during which sponsoring employers had to make up shortfalls in scheme funding, the removal of the requirement for certain schemes to obtain annual certifications of the adequacy of the scheme’s schedule of contributions to enable it to meet the MFR, and the introduction of stricter conditions on voluntary scheme wind-up.
4.411. The submission to the Minister said, in relation to the equity MVA proposal, that this aimed at ensuring ‘that the assets which schemes have to hold relative to their MFR liabilities under current economic conditions remains consistent with the original intentions of the MFR’.
4.412. The submission, in its detailed treatment of this proposal, stated that:

As part of its role in reviewing the actuarial basis for the MFR, the Pensions Board of the F&IoA have concluded that changes are needed to the equity MVA in order to align the MFR more closely to the level of protection originally envisaged. The changes are considered necessary mainly because of the trend towards reduced levels and non-payment of dividends by companies (which has the unintended effect of causing the MFR to operate at a level in excess of its original strength), and the increase in life expectancy.
4.413. The submission continued:

Increased life expectancy requires an increase in MFR liabilities. The reduction in dividend yields requires a lowering of the MVA. The F&IoA recommend that the overall impact of these factors can be addressed by lowering the dividend yield in the MVA from 3.25% to 3%. You will recall that the
Pensions Board wrote to officials on 5 September 2001 recommending this change. Our response [given on 23 October 2001] explained that we were currently consulting on a balanced package of changes to the MFR and did not propose to make piecemeal changes. But that we would consider this suggestion along with any others we received as part of the consultation exercise.

4.414. It went on:

GAD’s advice is that adjusting the MVA now in the way proposed by the F&IoA is justified under current circumstances. This change will lead to an estimated reduction in MFR liabilities of 7.7% in respect of scheme members who are more than 10 years below pension age, with more modest reductions for those closer to normal pension age. This returns things to the level when the MFR was introduced.

4.415. This part of the submission then set out officials’ recommendation that the Minister ‘agree to adjust the MVA in line with the F&IoA’s suggestion’.

Consultation on Myners


4.417. These related to Myners’ recommendations:

(i) that where trustees were taking a decision, they should be able to take it with the skill and care of someone familiar with the issues concerned;

(ii) that there should be a statutory requirement for funds to have independent custody; and

(iii) that UK law should incorporate an activist duty (similar to one imposed under US legislation) on those responsible for the investment of pension scheme assets.

Responses to the September 2001 consultation

4.418. Also in February 2002, DWP and the Treasury published a summary of the responses they had received to the consultation on the draft Regulations to make interim changes to the MFR (see above).

4.419. In the light of those responses, the Government said:

(i) that it had decided to proceed with the extension of the deficit correction periods, although this proposal was modified so that the extended periods would apply to new schedules prepared following an MFR valuation, irrespective of the date of the valuation;

(ii) that it had decided to proceed with the removal of the annual recertification requirement for schemes that were 100% funded on an MFR basis, although it was now proposed that, in order to qualify for exemption from the requirement, a scheme had to be ‘fully funded’ both at the effective date of the last MFR valuation and at the time of the funding estimate undertaken for the purposes of certifying the subsequent schedule of contributions;

(iii) that it had made a number of revisions to the detailed draft Regulations to implement the proposal to impose stricter conditions on voluntary wind-up and that the Government would continue to examine what arrangements should apply in areas linked to the MFR as part of the work to develop its replacement.

4.420. While recognising that this had not formed part of the draft Regulations that had been issued for consultation, the Government also announced that it had accepted a recommendation from the Faculty and Institute of Actuaries to amend the MFR equity market
value adjustment from 3.25% to 3%. The Government said:

This change would take account, in a simple and straightforward way, of the overall impact on the strength of the MFR test caused by reductions in dividend payments made by companies, and of mortality improvements, and align the strength of the MFR test more closely with its original intended strength.

4.421. The document ended with the statement that the Government would feed other comments it had received during the consultation process into the work it was doing to work up proposals for the replacement of the MFR, assisted by the Consultation Panel.

The Occupational Pension Schemes (Minimum Funding Requirement and Miscellaneous Amendments) Regulations 2002

4.422. The Regulations to put the interim changes to the MFR basis into effect were made on 22 February 2002 and laid before Parliament on 26 February 2002.

4.423. The Regulatory Impact Assessment that accompanied the Regulations noted that there had been widespread criticism of the MFR since it had been introduced. It then set out again the specific interim measures being implemented by the Regulations and argued that the risks of not taking this action would have been:

(i) that schemes would have continued to have had to respond to short-term market fluctuations over an inappropriately short time frame. This would have distorted investment behaviour by encouraging extra investment in gilts (to reduce volatility), or led to short-term cash injections, which may have damaging consequences for the employer, and would have acted against the long-term interests of members;

(ii) that well funded schemes would have continued to have had to invest time, energy and money every year on complex checks which were of doubtful value; and

(iii) that scheme members would not have benefited from the greater security which would be provided by the changes to the calculation of the debt on the employer when a scheme wound-up voluntarily.

4.424. The Assessment then set out the rationale for the Government's decision not to impose debt on the sponsoring employer in scheme wind-ups of the full amount needed to buy out the pension liabilities of all members through traditional or guaranteed deferred annuities:

While the Government is keen to strengthen protection for members when their schemes wind up, moving to such a stringent requirement would lead to high and uncertain costs hanging over ongoing schemes. This could be unsustainable for many UK companies and could have damaging consequences, including scheme closures in some cases. This would be in no-one's interest.

It should also be realised that guaranteed deferred annuities are not necessarily the most appropriate vehicle for younger scheme members, who might do better over the long period before retirement by investing the value of their existing pension rights in a stakeholder pension or other arrangements.

Finally, the very large size of some schemes is such that movement to an annuity buy-out basis for wind-ups might simply be impractical: there are doubts as to whether the insurance industry could deal with what might be required.

4.425. The Assessment then considered the relative costs and benefits of the Government's proposals.
4.426. In note 4 to the press notice which accompanied the laying of the Regulations, DWP confirmed that it had approved, on the recommendation of the actuarial profession, the reduction in the equity market value adjustment associated with the MFR test (see above).

4.427. In the debate in the House of Commons Standing Committee on the Regulations on 14 May 2002, the then Minister, Maria Eagle, explained that ‘the Regulations were introduced to improve the way in which the MFR operates in the period up to its replacement’.

4.428. When asked whether the Regulations would speed up the wind-up of insolvent employer schemes, the Minister replied:

The hon. Gentleman should not go away thinking that the regulations apply to the winding up of insolvent schemes. They do not. Delays often occur in respect of insolvent companies but the regulations do not apply to such situations.

4.429. In relation to concerns about the increasing number of final salary schemes that were closed to new entrants, the Minister replied that ‘some 8 million people remain in defined-benefit schemes, so we should not overplay the seriousness of what has happened’. She continued:

Reading the newspapers, one might get the impression that schemes are closing every day and that people in schemes that close no longer have pensions, but that is not the case. Most schemes close to new members alone; very few close to existing members, although that has happened... the situation is not all doom and gloom.

Press notice by actuarial profession

4.430. On the same day as the MFR changes were announced, the actuarial profession released a press statement, which had been seen by DWP in draft, under the heading ‘actuarial profession welcomes Government’s changes to MFR’.

4.431. This statement began:

Today’s government changes to the Minimum Funding Requirement (MFR) are a helpful easing of the burdens on employers. We hope the changes will encourage employers still to sponsor occupational pension schemes – particularly those of the defined benefit type. [The then] Chairman of the actuarial profession’s Pensions Board warned that the Government does need to be honest and open about the impact of any such measures on member security, particularly if, as a consequence, there is an increased chance for some members that the pension they expect will not be delivered.

We recognise that the government’s task is not an easy one – it isn’t possible to bolster member protection in occupational pension schemes and at the same time reduce the cash burdens on employers. These are conflicting objectives.

4.432. The statement continued to outline the changes that it specifically welcomed, which it listed as being:

- the ‘acceptance of the change we recommended to the... [equity] MVA – to recognise current market conditions and the lower dividend payouts in recent years. This change eases the burdens on employers by reducing the amount needed to meet the MFR. But it also reduces the amount of minimum transfer values for people changing schemes’;
- the ‘extension of the “deficit correction period” giving employers the extra flexibility which they have been seeking in funding patterns and their own cashflows, but still within a disciplined framework for funding their schemes’;

Press notice by actuarial profession
the ‘reduced administrative burdens on trustees and employers by removing annual recertification for schemes that pass the MFR test. However this could give a lower level of member protection for such schemes and this should be recognised by the government’.

4.433. However, the profession went on to:

...caution that:

• the removal of these annual funding checks means that, for as long as 3 years, there will be no statutory mechanism to check that contributions by the employer are still sufficient when the next actuarial valuation is due;

• the fact that a scheme is funded at the level of 100% on the MFR basis is no guarantee that it will continue to be so over the next three years. A significant proportion of schemes have seen reducing MFR funding levels over the past three years. In current conditions an interval of 3 years between valuations is one in which funding levels can decline rapidly. Scheme trustees and their advisers will need to continue to be watchful in carrying out their duty towards pension scheme members; [and]

• we also recommended that the government should not implement the removal of annual funding checks, if no workable solution could be found to provide compensating provision to protect members. In the event the government has introduced the dispensation but has decided to apply it to schemes with funding levels lower than we believe wise, especially in current conditions. This causes us concern.

4.434. The statement concluded by saying:

The interim amendments to the MFR made by the Department for Work and Pensions today follow consultations in which we participated actively. We also co-operated closely with the DWP in making the necessary changes to two of our professional guidance notes, which we are also releasing today.

**Revised Actuarial Guidance Note**

4.435. On 7 March 2002, the actuarial profession formally issued a revised version (1.6) of their guidance note, ‘Retirement Benefit Schemes – Minimum Funding Requirement’ to reflect the above changes to the MFR basis.

**Actuarial profession’s briefing statement on abolition of the MFR**

4.436. Also in March 2002, the actuarial profession issued a briefing statement entitled ‘reform of the MFR: consequences of the abolition of the MFR’, which ‘set out the thoughts’ of the Faculty and Institute of Actuaries on these matters.

4.437. After noting that the precise form of replacement had yet to be determined, the statement continued:

...there is an advantage in linking the amount payable by the employer when a scheme winds up and the priority order. This would help ensure that, when a scheme winds up and the employer pays any debt in full, the assets of the scheme would be sufficient to satisfy any priorities set by Government. This would improve on the current situation where an employer can satisfy the debt on the employer regulations by ensuring that the pension scheme has assets to cover both pensions in payment and deferred pensions. However, when pensions in payment are secured, the priority order allocates them funds equal to the cost of purchasing annuities. Annuities currently tend to cost more than the value of a pension in payment on the MFR basis. Hence, currently, where an employer pays this debt in full, the assets remaining after purchasing annuities for pensioners, tend to be insufficient to pay full transfer values for deferred pensioners.
Parliamentary questions on scheme wind-up and under-funding

4.438. On 18 March 2002, the then Minister, Malcolm Wicks, replied to a question from Colin Pickthall MP, who had asked what mechanisms were proposed by the Government to prevent companies from winding-up, closing down or fundamentally altering pension schemes without the consent of scheme members; what measures the Government proposed to introduce to encourage the continuation of final salary schemes; and whether the Government would bring forward proposals for legislative reform to increase member protection.

4.439. The Minister replied:

Occupational pension schemes are provided voluntarily by employers, and they are therefore free to decide whether to continue to provide such pensions in the future. The legislation that is in place is to ensure that the pension rights that individuals have already built up in schemes are protected...

The Government have already announced proposals to replace the minimum funding requirement (MFR) with a long-term scheme specific funding standard in the context of a regime of transparency and disclosure, with additional measures to strengthen security. This will be taken forward as soon as parliamentary time is available. Meanwhile the Government announced a package of changes on 26 February to improve the way the MFR operates in the period leading up to its replacement, and increase protection for pension scheme members where an employer decides to wind a scheme up voluntarily.

We have asked Alan Pickering and Ron Sandler, in two separate studies to review the regulation and operation of the pensions, and the wider market of savings products, including final salary schemes. Alan Pickering will report, with recommendations for reform, in June and Ron Sandler will also report around that time.

The Government will then set out its proposals, which will build on the reforms put in place since 1998, and on which it will consult, to simplify the regulatory system, to look at how the Government and employers encourage and support pension savings, and to make sure that the most appropriate incentives for savings in retirement are in place.

We have already announced last month an interim package of measures to improve the way the minimum funding requirement works, which will reduce compliance costs for employers with defined benefit pension schemes.

4.440. On 21 May 2002, in response to a question from Peter Duncan MP, the Minister explained that, in 2000, 13% of private sector final salary schemes had been under-funded on an MFR basis, made up of 6% which were funded at a level below 90% of the MFR level and 7% funded at between 90% and 99% of that level. He also explained that, by February 2002, it was estimated that the total proportion of under-funded schemes had risen to one in six.

Revised Actuarial Guidance Notes

4.441. Meanwhile, on 19 March 2002, the actuarial profession had issued a revised version (4.2) of their guidance note, ‘Retirement Benefit Schemes – Winding-up and Scheme Asset Deficiency’ and also a revised version (2.0) of their other guidance note, ‘Retirement Benefit Schemes – Minimum Funding Requirement’.

Accuracy of information project

4.442. On 22 March 2002, the DWP departmental board signed off the final report of its ‘Accuracy in Information’ project.

4.443. The project had been established in April 2001 in the light of critical reports by my
predecessor and the Comptroller and Auditor General, both issued in March 2000, concerning the quality of the information that had been provided by DSS in relation to changes made by legislation to the arrangements for the inheritance of SERPS.

4.444. The National Audit Office report had said:

Where the Department provide publicity about legislative changes, they have a responsibility to ensure that the information is correct and not misleading. We consider, therefore, that:

a) the Department’s new procedures for ensuring the contents of leaflets are complete and accurate should in the future be applied systematically to all publicity material, including electronic sources. Although the Department are responsible for the quality of their publicity, they should also consider how they can engage pressure groups and other interested parties more in consultation on the text of new leaflets and other publicity material. They should also ensure that the new arrangements allow for the handling of ad hoc corrections notified to the Department outside the regular review process;

b) particular attention should be paid to ensuring that information about changes to legislation that do not come into effect for some years is included in publicity material;

c) given the potential consequences of incorrect and incomplete leaflets, this area remains high risk, and we suggest that the Department’s Internal Audit Service undertake a regular review to ensure that the new arrangements for ensuring complete and accurate leaflets are being implemented effectively; and

d) the current work to develop the information provided in state pension forecasts (the means by which citizens are able to obtain a projection of what pension they will receive at state retirement age, based on a series of assumptions), and the amount of explanatory material accompanying it, should be progressed as soon as possible as part of the wider improvements to the information about pensions available to citizens.

4.445. Legal advice provided to the project team on 26 May 2000 had confirmed earlier advice, given on 17 November 1999, that the Government was not under a general duty to provide information or advice. It also said that, if it did so in circumstances where the recipient could be expected to rely on it, the Government would be liable for loss resulting from the information or advice ‘being incorrect’.

4.446. The adviser noted that ‘being incorrect’ included ‘telling only part of the story’. The legal adviser continued (with my emphasis):

On the face of it, the best general approach would seem to be for the Department to concentrate on administering the system and providing appropriate information about it. We should leave the task of giving advice to the professional advisers like CABx and Age Concern and make sure that to the extent that they have information from the Department it is clear and reliable so that they can perform their functions most effectively.

4.447. On 31 May 2000, the Policy Director of DSS had stated that ‘in the pensions context, the department believes that its role should be to give accurate information on the options available but to avoid giving advice on which option to choose’.

4.448. Further legal advice had been provided on 8 March 2001, which had confirmed the earlier advice and which, in a DWP official’s summary of
it, had said that ‘where we choose to give information it is incumbent on us to ensure it is accurate, complete and can be relied on’.

4.449. On 11 September 2001, the Executive Team of DSS had been invited to agree a Departmental objective on accuracy which was defined broadly as being that ‘all information provided to customers by any part of the DSS, by any method, should be accurate and up-to-date, with no significant omissions’ (with original emphasis). This objective had been agreed and the minutes of that meeting had stated that further consideration of the impact of this objective ‘was particularly relevant to the development of the Working Age Agency [later to become JobCentre Plus] and new Pensions organisation [which later was named the Pensions Service]’.

4.450. The project led, in line with its aims, to the development of agreed definitions of ‘information’ and ‘advice’ and of the department’s role in relation to both; to the adoption of information and advice standards frameworks within each part of the department and implementations plans for each; to a DWP Information Strategy; and to a content review process for public information leaflets.

4.451. It also led to the revision of ‘Financial Redress for Maladministration’ to, among other things, incorporate the agreed role of the department in relation to information and advice and also the new definitions of both.

The work of the Consultation Panel
4.452. On 7 May 2002, the MFR Consultation Panel met to discuss ‘reform of MFR: consequences for allocation of assets on wind-up and scheme asset deficiencies’ as part of its series of themed meetings. It discussed possible ways of requiring the disclosure to scheme members of various types of information about their scheme within the new statutory regime to be implemented, and what that information should contain.

4.453. The minutes of the Panel’s meetings make clear that there was little general agreement about how best to communicate scheme funding issues to scheme members in terms which were accurate or ‘fit for purpose’ while being at the same time generally understood.

Occupational Pensions: Your Guide
4.454. In May 2002, DWP published a leaflet called ‘occupational pensions: your guide’ (PM3). This 28-page leaflet began by stating (with original emphasis):

Everyone needs to plan ahead for retirement. The basic state Retirement Pension will give you a start, but you’ll need to build up a second pension to make sure you have the lifestyle you want in retirement. And the sooner you take one out, the better.

To help you, this guide tells you how occupational pensions work. It looks at some of the questions you may need to think about and it tells you where you can find more information...

These guides can give you helpful information, but only you can make decisions about your pension.

4.455. After describing what an occupational pension is and the links between such a pension and the state additional pension, in a section headed ‘is an occupational pension a good choice for me?’, the guide continued:

For people in work, occupational pensions are usually a very good way of saving for a second pension. But the effectiveness of any occupational pension will depend on your working patterns and your personal circumstances, such as your pay.

Generally, if you work and your employer offers you an occupational pension scheme... you would be better off joining it... If you are already a member of an occupational pension scheme, you may already be in the most beneficial pension
arrangement. Occupational pensions are usually a very good deal, so... check it out carefully when you are looking at your pension options.

4.456. The guide continued with an explanation of the different types of scheme, the tax relief arrangements and the possibilities for making additional contributions to schemes. It then went on to discuss 'how do I know my money is safe?':

Although your employer pays into the scheme and may be a trustee, the assets of the pension scheme belong to the scheme and not to your employer. As a scheme member, you are protected by a number of laws designed to make sure schemes are run properly and to make sure funds are used properly.

In particular, there are laws about:
- the way occupational pension schemes must be run;
- the information you must be given;
- people who are not eligible to be trustees...;
- some of the trustees being nominated by the members;
- who the trustees should be...;
- the way the funds are invested;
- the records that the scheme provider must keep; and
- who is authorised to manage pension investments.

4.457. In relation to regulation, the section continued:

OPRA is responsible for regulating occupational pension schemes. They can act quickly to protect your interests if the trustees who run the scheme, or your employers, do not meet their obligations.

4.458. After dealing with the position if the reader changed employment, the guide informed them of other sources of useful information provided by DWP and the Inland Revenue and also explained the rules regarding scheme dispute resolution procedures and the arrangements for pension sharing on divorce.

4.459. The back of the guide stated that 'this leaflet is for guidance only: it is not a complete statement of the law'.

**The Sandler Review**

4.460. The Treasury published the report of the Sandler Review on 9 July 2002, which had been led by Ron Sandler, a former chief executive of Lloyd's of London. The Review, whose report was entitled 'Medium and Long-Term Retail Savings in the UK', had been announced on 18 June 2001, with a remit to 'identify the competitive forces and incentives that drive the industries concerned, in particular in relation to their approaches to investment, and, where necessary, to suggest policy responses to ensure that consumers are well served'.

4.461. While noting that there was much positive about the financial services industry, the report identified a number of causes for concern. These were the high degree of complexity (including the wide use of 'technical terms which are largely incomprehensible to the layman'), considerable opacity and a resulting inability to compare products and providers, consumer detriment caused by commission-driven selling, and problems with institutional investment decision-making. The report considered that these had contributed to a problem of consumer reluctance to save, particularly among the lower-paid.

4.462. After considering these concerns in detail, the report then set out its view as to what a well-functioning market for retail savings might look like. It said that such a market would be one
in which, among other features, consumers had a reasonable understanding of retail savings products, where proper competition for authoritative, high-quality and reasonably priced advice flourished, where products were simple and straightforward, and where consumers, particularly in lower income groups, could reasonably easily access the markets for products and advice.

4.463. The report then went on to recommend the development of ‘stakeholder’ savings products to realise the aim of maximising the saving potential of all groups in society.

ASW goes into receivership
4.464. On 10 July 2002, Allied Steel and Wire went into receivership. The official receiver for the company, which employed about 1,000 workers in Cardiff, 400 at Sheerness in Kent, and 30 in Belfast, began to wind up its two final salary pension schemes one week later. This followed BUSM in 2001; Dexion went into receivership in 2003.

4.465. Early estimates were that the ASW schemes would only be able to meet approximately ten per cent of their liabilities towards non-pensioner members. At the same time, the ASW Sheerness scheme was reported as being 104% funded on the MFR basis.

The Pickering Review
4.466. The Government published the Pickering Review on 11 July 2002. The Review – whose report was entitled ‘A Simpler Way to Better Pensions’ – had been announced by the Government on 26 September 2001 and had been led by Alan Pickering, a former head of the National Association of Pension Funds.

4.467. Its terms of reference had been to carry out a comprehensive review of DWP private pensions legislation to identify a ‘package of options for simplification and the reduction of compliance costs’; to consider the principles behind the legislation as well as its supporting processes and ensure that the law was proportionate to the policy purpose; to consider the means by which the regulatory framework was enforced; to identify areas of simplification which could be achieved by secondary legislation and identify more fundamental reforms to be achieved by primary legislation; and to report to the Secretary of State by July 2002 with proposals for simplifying the regulatory framework that did not compromise the security of individuals’ investments.

4.468. The review was to have regard to the need to maintain effective protection for pension scheme members; wider economic and exchequer effects; the links with and impacts on tax rules and work being done on this by the Inland Revenue; the separate work to implement the recommendations of the Myners review and to reform the MFR; and the work of the forthcoming five-yearly review of OPRA.

4.469. The Review’s objective, the report said, was to identify ways to make it easier for employers to provide good quality pensions for their employees, easier for commercial providers to sell appropriate products to appropriate people, and easier for individuals to accumulate pension benefits.

4.470. The report identified three key themes: first, the ‘need for a proportionate regulatory environment’; secondly, ‘a pension is a pension is a pension’; and, finally, ‘more pension, less prescription’.

4.471. The key proposal of the Review was that a new Pensions Act was required to consolidate all existing pensions legislation and to deliver reform.

4.472. In relation to the provision of information to scheme members, the report suggested that
too much emphasis had been placed on the provision of information by schemes and that, whilst this was an important issue, such disclosure was not a panacea. The report acknowledged that communication had a role to play in alerting members to risks and enabling them to take action to protect their interests, but asserted that the provision of information had much more to do with consumer enlightenment than with benefit security.

4.473. The report concluded that the provision of too much, poorly targeted information had resulted either in information being ignored or in people failing to take action which it had been in their interests to take.

4.474. It recommended that any communications should be based on the following principles:

(i) communication should be aimed primarily at influencing behaviour. The information should give individuals the facts they needed to decide whether to join, stay in or leave a scheme;

(ii) communication should provide members with basic information about their likely pension – including setting out (in broad terms) the risks;

(iii) individuals should be properly informed of major events which might affect members and their options on leaving or retiring or what would happen to their pension if they die;

(iv) it was also necessary to provide information to assist the protection of members – people in defined benefit schemes should have access to information about their scheme's funding position; and

(v) all communication with members should be tested to see whether it was understandable and would work.

4.475. The report recommended that only key pieces of information should be sent automatically to members, with all additional information being available on request.

**OPRA guide to winding-up**

4.476. On 6 August 2002, OPRA published a guide which outlined the new arrangements for, and its new powers to speed up, the process of winding-up pension schemes, which had been introduced in April 2002. The guide was published as an 'exposure draft'.

4.477. In appendix 3 to the guide, OPRA said:

> Some time ago [NICO], in consultation with the pensions industry, made plans to deal with the delays in providing membership listings and relevant calculations... Most reconciliation issues centre on agreeing the scheme membership and the main reason for the problem is the provision of inconsistent information to both the scheme administrator and [NICO]. Part of the solution is good record keeping during the lifetime of a pension scheme and regularly updating [NICO] and administrators about changes. OPRA and [NICO] work closely together to ensure a consistent approach.

**DWP evidence to Select Committee**

4.478. On 4 October 2002, DWP submitted a memorandum to the parliamentary Select Committee on Work and Pensions, which oversees its work. This set out the background to, and the detail of, the Government's reform agenda.

4.479. In a section entitled 'role of the state', DWP said that:

> The immediate role for the state is to provide help and encouragement for people to save, providing the right rewards for saving, and making sure it pays to save. It must also ensure proper protection for savings. As part of that role, the Government is examining ways to strip away
some of the layers of regulation that have built up around some pension and savings products; and provide clear and accurate information about what pensions will provide so that people will understand how much they can expect at retirement before it is too late to do something about it.

4.480. In explaining the role of the recently established DWP agency, the Pensions Service, the memorandum explained that one of its roles would be to ‘improve the service to future pensioners, by providing accurate information to help them make decisions about saving for their retirement’.

4.481. It continued:

The Department is actively promoting a pension education publicity campaign that is supported by a range of simple, impartial guides. The purpose of the campaign is to promote awareness of the importance of saving for retirement with the objective of encouraging people to save. The main elements of the campaign include media and TV advertising, and direct marketing to specific target groups such as young people, women and the self employed.

4.482. The memorandum went on to state the Government’s intention to ‘continue to encourage people to take out private pension provision as part of its overall savings strategy, by making people more aware of the “need” to save and how much pension a given level of saving will guarantee, and by increasing people’s knowledge of the options available’.

4.483. It then explained that the provision of final salary schemes was something that ‘the Government will want to continue to positively encourage in the future’ although ‘it is not the Government’s role to champion the cause of either defined benefit or defined contribution schemes’.

4.484. In the subsequent Select Committee report, which was published on 14 April 2003, the Committee recommended, in relation to financial education, that the FSA pass some of its functions, especially those related to the marketing of – and education about – pensions, to the proposed new regulator; that the Government support a pilot scheme to improve financial literacy; and that, with each substantive change to state benefits, an impact assessment of these changes on savings patterns should be produced and published.

**The NAO report on OPRA**

4.485. On 6 November 2002, the Comptroller and Auditor General published a report by the National Audit Office (NAO) called ‘OPRA: Tackling the Risks to Pension Scheme Members’.

4.486. The NAO report found that the then current regulatory arrangements addressed only some of the risks to pension provision. It continued:

There is little, however, that any regulator could do directly about one of the biggest risks to pension scheme members receiving the pension they expect, that of the employer going out of business or closing the scheme. Employers are not obliged to provide an occupational pension scheme and incur significant cost in supporting one. Scheme trustees are volunteers, mostly unpaid, whose dedication and goodwill is essential to good governance. The burdens of regulation, including Opra’s actions, could increase the risk of employers closing their schemes to the detriment of the members concerned.

4.487. A footnote to the above paragraph explained further:

If the employer closes the scheme, it is still liable to fund for pension rights already accrued. If an employer becomes insolvent, then insufficient funds may mean that all members may suffer – pensioners and, more probably, employees (future...
The risks to members once a scheme is closed relate to pension rights that an employee would have expected to gain in the future.

4.488. The report also set out the NAO’s findings that OPRA had encouraged better governance of pension schemes; that it had little information on the outcome of its work; that such work had focused on reports about matters that posed a low risk to scheme members; that it had taken a long time to develop its approach to the identification of high risk schemes; and that its objectives did not clearly articulate how its work should protect scheme members.

4.489. It recommended that OPRA should:

(i) become better informed of the risks facing pension scheme members as the lack of information it possessed constrained its ability to identify risks to members’ pension rights;

(ii) produce a document that set out its regulatory functions and objectives clearly so that it could be seen to perform those consistently and transparently;

(iii) develop different communication approaches for different types of scheme, including guidance on the features of a well-administered scheme;

(iv) utilise distinct but proportionate regulatory approaches for different types of scheme;

(v) shift their resource allocation to target schemes and common weaknesses posing the greatest risks;

(vi) focus more regulatory effort on providers and third-party administrators; and

(vii) raise the threshold for the reporting by whistleblowers of breaches of pensions legislation so that only material breaches were reported.

4.490. The report also recommended that DWP, in developing proposals for a new regulator, should be clear about what it expected from the new body and how it should report performance against this expectation – and should consider whether the new regulator should act as the centre of expertise on occupational pensions.

4.491. In the subsequent Committee of Public Accounts report, published on 31 March 2003, the Committee came to four ‘main conclusions’. These were:

(i) that OPRA and DWP had been slow to develop objectives and tackle legislative constraints and as a result had failed to address major risks to pension scheme members;

(ii) that OPRA did not consider that it had the power to prevent another Maxwell case;

(iii) that OPRA had done little to check the suitability of trustees or the appointment of advisers to pension schemes; and

(iv) that OPRA had focused on trivial cases.

4.492. The Committee also commented:

Many pension schemes have been closing to new members, reducing the benefits they provide, or are insufficiently funded to meet all members’ entitlements if they are wound up. Many scheme members are concerned about the security of their retirement income and others may be making insufficient provision. OPRA has little role at present in tackling these concerns, since its focus is on the way pension schemes are governed, but its expertise could be used to inform the future of pension provision. A new regulator would be more effective with a wider-ranging role in advising the Government on pensions-related issues in general, such as the closure of schemes with insufficient assets to
meet their commitments to all members, and educating employees and trustees on how to make pension choices.

**Select Committee on Work and Pensions hearing**

4.493. On 4 December 2002, the parliamentary Select Committee on Work and Pensions took evidence from OPRA, from the Pensions Ombudsman, and from the Chief Executive of the Occupational Pensions Advisory Service (OPAS) as part of its inquiry into the future of pensions in the UK.

4.494. In a discussion on the MFR, the Chief Executive of OPAS said:

There is a great deal of misunderstanding about the minimum funding requirement; certainly as far as scheme members are concerned, if they have heard of the phrase at all, they think that it is some sort of solvency test, some sort of guarantee that in the event of something going wrong, they will get their full pension entitlement.

4.495. He continued:

The minimum funding requirement is not that, it is simply a requirement that a scheme has to be funded over a period of time to match a level which will guarantee the pensions in payment and some part of the pensions entitlement of those who have not yet retired. It is a very imprecise measure of funding. One of the great problems is that many employers are now seeing this as a maximum funding requirement as distinct from a minimum funding requirement. We have seen one or two quite bad examples recently of very large employers who have decided to close down, to wind up their pension schemes and they have been content to limit the funding at that point in time to the level of the minimum funding requirement. This has meant that the pensioners have continued to get their pensions, but the active and deferred members, people who have not yet retired, are only getting 50 to 60% of what they believed to be their pension entitlement.

4.496. The Chief Executive then said:

There is a fundamental problem there with a minimum funding requirement and if we are going to have a funding requirement, it should be a proper one and should attempt roughly to match the anticipated liabilities of the scheme so that in the event of an employer choosing to wind up a scheme, and that is his decision and I am not challenging that in any way, then the money is guaranteed to meet most if not all the pensions in payment. That is a situation where the employer is solvent. Where the employer is insolvent, you have a very different situation. It is often the case in my experience, that an insolvent employer will leave behind him an insolvent pension scheme below the minimum funding requirement or even only at the minimum funding requirement in the best cases.

In that situation you have a real problem because the members, even pensioners, are not guaranteed to get all the pensions. What happens in practice is that all the funds are then used based on a priority order which is laid down in regulations to try to fund the pensions in payment, leaving very little for anyone else.

The example I quoted in my submission to you is of a man who paid into a final salary scheme for 38 years and was on the brink of retirement when suddenly the employer went bust, the pension scheme was found to be underfunded and he ended up after 38 years with a fraction of the pension he was expecting to get. That is a devastating situation for somebody in that position.

Something needs to be done to address that. If we cannot amend the minimum funding requirement
to guarantee a level of pension, and it might be very difficult with an employer who has gone insolvent, then it may be the approach is the other way round, some sort of insurance.

**BBC story on Sea-Land wind-up**

4.497. On 13 December 2002, the BBC ran a story — under the heading ‘Did the Maxwell affair change nothing?’ — about the winding-up of the pension scheme for staff at Sea-Land — a division of Maersk, the Danish shipping group.

4.498. After setting out the background to the case and its similarities with other examples — including that of the scheme of which Mr J was a member — the article quoted a spokesman for OPRA as saying:

> When a pension [scheme] is 100% funded for the minimum funding requirement there may only be money in there for 40% of the benefits.

4.499. The article then quoted work done for the BBC by a leading actuarial consultancy which estimated that, since the beginning of 2002, the level of funding in employer schemes which invested most of their money in shares had shrunk by an average of 15% to 20% and that three-quarters of the UK’s pension schemes were in deficit, compared to less than half in January 2002.

**The further Green Paper on Pensions**


4.501. The then Secretary of State for Work and Pensions, Andrew Smith, in the Foreword to the Paper, said that the Government’s aim was to ‘help people choose how they plan for retirement, how much they save and how long they keep working’.

4.502. In the words of its summary, the Paper set out:

> ...the Government’s proposals to renew the partnership between the Government, individuals, employers and the financial services industry which has long been a strength of the UK pensions system.

The new proposals will:

- help people make better informed choices about their retirement;
- reaffirm the role and responsibilities of employers in the pensions partnership, improving saving through the workplace, and providing greater protection for members of occupational schemes;
- encourage simple and flexible savings products, broadening access to the financial services industry; and
- introduce measures to extend working lives.

4.503. The Paper set out the ‘background of increasing concern’ over the adequacy and security of pension provision in the UK. The main concerns it discussed were increased longevity, signs of a decline in work-based pension provision, the complexity of pension products, the cost of financial advice, the legacy of personal pensions mis-selling, and a trend towards earlier retirement. It also referred to the fact that ‘employee confidence has also suffered due to the action of a few companies, who have let their employees down when they have become insolvent with an under-funded pension scheme’.

4.504. Under a heading ‘informed choice for individuals’, the Paper continued:

> The Government provides the foundation of pension income, but in a voluntary system the amount people should save in addition to the
basic State Pension will depend on their own circumstances and preferences... Current estimates show that up to 3 million people are seriously under-saving for their retirement – or planning to retire too soon. In addition, a further group of between 5 and 10 million people may want to consider saving more, working longer, or a combination of both, depending on their expectations for retirement.

The Government believes this reflects the fact that choice is currently frustrated by complexity and confusing flows of information which do not relate clearly to an individual’s circumstances, by hard-to-compare products and by expensive advice. The Government wants to help people make better informed choices about their retirement and believes that those who seem to be saving too little will save more if:

(i) there is a simpler framework to help people understand their choices; and
(ii) individuals are equipped to understand financial choices and receive clear information tailored to their own circumstances.

4.505. After setting out the Government’s proposals to simplify the tax regime for pensions, the Paper continued:

The Government recognises the value of good information in helping people to make informed choices, and will continue to work with the FSA to improve basic financial literacy and make sure that individuals are equipped to understand financial choices.

But the Government also believes that providing tailored information based on an individual’s circumstances will make the biggest difference and encourage people to save more.

4.506. It then set out the proposed approach to achieve this, which included strategies:

(i) to increase the number of people receiving forecasts of their pension income – for example by working with employers and scheme providers to increase the uptake of the combined state and non-state forecasting service; and
(ii) to improve the range of services providing tailored information – by offering integrated telephone and internet services and by issuing information at key points in people’s lives to encourage greater awareness and understanding of savings options.

4.507. The Paper also set out the Government’s aim to make it easier for employers to set up and run good pension schemes. This would be complemented by a strategy to simplify the complexity in pensions legislation and the associated tax regime.

4.508. Key elements of this approach would be the removal of unnecessary administrative and tax burdens, the replacement of the MFR with a scheme-specific funding standard, the simplification of the structure of contracted-out benefits, and the consolidation of existing legislation. The replacement of the MFR was described as being able to ‘make the funding position more transparent for members’.

4.509. The Paper went on to note that these simplifications could save employers between £150 million and £200 million a year in administrative costs but that there was a balance to be struck in the reform process with the need for better protection for scheme members.

4.510. It continued:

The Government is determined to ensure that reduced regulation and red tape around pensions is married with greater protection for consumers.
to give them the confidence they need to join schemes. This is why the Government is proposing a new pensions regulator that will focus on protecting the benefits of scheme members. The new regulator will operate proactively to anticipate problems, concentrating its effort on schemes where it assesses that there is a high risk of fraud, bad governance or maladministration. To reinforce this approach the Government is also looking at proposals to protect members when problems do arise, such as when employers become insolvent or when there is insufficient funding in the pension scheme to meet all the pension liabilities.

4.511. The Paper summarised the proposals set out in the Green Paper as being 'better information, simpler pensions, simplified tax treatment, better protection, and more flexible retirement' which were 'designed to enable people to make their own choices for retirement'.

4.512. Chapter 3 of the Paper dealt with 'informed choice in pensions – choices for individuals'. It started with the recognition that there were a 'range of barriers' to pension saving in the UK and that these barriers needed to be addressed. It then stated the Government's belief that people would be more likely to make adequate provision for their retirement if there was a simple framework of law and regulation governing pension provision, if they were equipped to understand financial choices, if they were provided with 'clear information tailored to their own circumstances', and if they were offered a choice of suitable products.

4.513. In relation to the role of official publicity in attempts to remove barriers to being able to navigate the pensions system, the Paper said, in paragraphs 31 to 33 of Chapter 3, that: The current government awareness campaign, supported by a series of pensions information guides, has been running since January 2001. More than 2 million copies of the guides have been distributed. The campaign so far has focused on making people aware of the need to save for retirement whilst also providing simple and impartial information on pension options.

The Department for Work and Pensions' research suggests that it is having the desired effect on public attitudes: more people agree that it is better to start saving sooner rather than later for retirement than did before the campaign began. However, similar campaigns (such as those on drink-driving or wearing seat belts) have historically taken a significant length of time to change public attitudes in a major way. The campaign must therefore be sustained over the long term.

We intend to build on the work that has already been done, by moving the emphasis of the campaign away from promoting simple awareness of the need to save, and towards information that will prompt people to take action. We will also ensure that the publicity campaign is linked into other initiatives, such as life events marketing..., that might be developed as part of this Green Paper.

4.514. With respect to the detailed discussion in Chapter 4 of the Paper about the security of final salary pensions, the Paper noted that: ...if they are to join schemes, prospective pension scheme members will want to have confidence that the pensions they are promised will actually be delivered. Most people receive the pension they are promised, but sadly there are exceptions. There has been a lot of concern in recent months about pension schemes that are being wound up, either through the decision of a solvent employer or as a result of the employer becoming insolvent.

We are determined to act to increase protection for scheme members. We will increase security but we will aim to ensure that in doing so we do
not increase the overall burden on employers providing pensions. Employers provide schemes voluntarily, and we need to ensure that they continue to choose to do so. We want this consultation to inform our strategy so that we can provide greater protection without risking scheme existence. We recognise this is a difficult balance to achieve.

4.515. The Paper then discussed the detailed proposals for inclusion in a new Pensions Bill. These included the establishment of a proactive regulator whose objectives and resources would be focused on protecting the benefits of scheme members; greater protection for accrued pension rights on wind-up through changes to the priority order in which liabilities would be met; a central organisation or form of insurance to protect scheme members whose sponsoring employer became insolvent; increased compensation in the case of fraud or dishonesty; and measures to ensure that members had the right to be consulted about changes to their scheme.

4.516. The Green Paper also sought views on whether insolvency law should be amended to give pension schemes higher preference than other unsecured creditors when the assets of an insolvent company were being shared out.

4.517. In relation to solvent employers who chose to wind up the scheme that they had been sponsoring, the Paper said:

When [employers] do this they need to make arrangements to meet the pension promise they have made to their past and present employees. There have been instances recently in which members have lost out substantially under these circumstances. The Government believes that members need greater protection against such losses.

In March 2002, we increased the amount of money that solvent employers have to put into the pension fund if they choose to wind up the scheme. This means that employers are required to put enough money in to buy annuities with an insurance company for pensioners (guaranteeing their full pension) and for people who had not retired, the value of their accrued benefits, worked out on the MFR basis (which they can transfer to another pension arrangement). It does not guarantee the full pension they were expecting as the transfer value is calculated by making assumptions about the level of investment growth between the time of wind-up and when the individual retires. If investment growth is more or less than assumed then the value of the pension fund at retirement could be similarly greater or smaller. With transfer values, therefore, the risks are borne by the individual.

After the replacement of the MFR with scheme-specific funding requirements, it will be for schemes to determine their own transfer values on a basis that is fair to all. As the MFR has provided a minimum measure of funding, we might expect that in many cases transfer values would be higher than the minimum amount that they were under the MFR.

4.518. The Paper then went on to seek views on whether the then current arrangements for buy-out should be strengthened and, if so, whether this should be done on a full or partial basis, with the latter only relating to existing pensioners and those close to retirement. Responses were sought to the issues summarised in annex 1 to the Paper by 28 March 2003.

4.519. The Paper was accompanied by a technical paper, published at the same time. A separate Inland Revenue consultation document, ‘Simplifying the Taxation of Pensions: Increasing Choice and Flexibility for All’ – on detailed proposals to simplify the tax treatment of pensions – was also launched that day.

The technical paper

4.521. The technical paper set out in more detail the Government’s proposals concerning changes to contracting-out, greater flexibility for schemes, the revaluation of preserved pensions, simplification of the rules surrounding pension transfers, pensions on divorce, transfer of undertakings legislation, transfers without consent, and the re-introduction of compulsory scheme membership in certain situations.

4.522. It also dealt with two issues relevant to this investigation: communication with scheme members (although the focus of this was on the communication of information to them by the schemes themselves) and the protection of pension rights in the case of wind-up.

4.523. In relation to communication with scheme members, the technical paper set out the relevant findings of the Pickering Report (see above) and the Government’s view on them, which was to accept most, but not all, of the Pickering recommendations.

4.524. In relation to the protection of pension rights during wind-up, the technical paper first set out the Government’s decision that pensions legislation should retain a statutory priority order and then asked for views on whether such a continued order should be based on either increasing the priority given to people who were approaching retirement age or basing the level of protection on the number of years an individual had contributed to the scheme, regardless of age, as had been proposed by Frank Field MP.

4.525. The technical paper continued with a discussion of the options for reform of the statutory priority order of creditors of insolvent companies. It set out the circumstances in which certain debts owing to pension schemes were treated as preferential debts and then explained that, in relation to other debts not covered by those circumstances, pension schemes were unsecured creditors who were categorised at the bottom of the list of creditors that could make a claim on the assets of the relevant company.

4.526. In relation to any reform of the priority order to give pension schemes higher priority, the technical paper sought views on what the right balance should be between the potential impact of such reform on business and the need to provide adequate protection for scheme members.

The quinquennial review of OPRA

4.527. The Government also published the report of the quinquennial review of OPRA on 17 December 2002. The review had been undertaken by Dr Brian Davis – a former Chief Executive of the Nationwide Building Society – with the purpose of commenting on the performance by OPRA in the discharge of its statutory functions and to make recommendations for the future.

4.528. The report’s findings were that OPRA was an organisation that had performed well within the limitations of the powers it had been given; that it had potential to take on a new and different role and to develop further; and that it was seen to be open and accessible. It reported that OPRA would welcome a more pro-active role.
The principal recommendations made in the review included:

(i) that occupational pension schemes would continue to require supervision by a regulator and that a ‘new kind of regulator’, to operate at ‘arms length’ from the Government, was needed to deliver the regulation of future revised pensions legislation;

(ii) that the current pensions environment and public expectation suggested that a pro-active regulator was needed – within a revised legal framework which set out its objectives clearly;

(iii) that the new regulator’s objectives should reflect the need to focus on the key risks to pension scheme members – and the need to be seen to be doing so;

(iv) that the current legal framework had meant that OPRA had processed high volumes of relatively low value reports and breaches – which was not consistent with a risk focused and pro-active approach and that this should be remedied in the revised legislative structure;

(v) that the new regulator’s guidance to scheme advisors should direct them to ‘blow the whistle’ only on breaches that were likely to have a direct impact on the security of members’ benefits;

(vi) that a pro-active regulator would not only investigate and sanction, but also encourage compliance through education and guidance;

(vii) that the number of bodies involved in the fields of pensions authorisation, sales, marketing, advice and regulation had led to confusion, which should be addressed;

(viii) that OPRA had produced ‘good quality publications and a popular website’ – and that the new regulator should build on this foundation; and

(ix) that OPRA had a low public profile but was well known amongst pensions professionals – the new regulator would need to decide on its key audiences for publications and other communications and to co-ordinate this with information issued by other bodies.

Parliamentary exchanges on scheme funding

4.530. In oral questions to Work and Pensions Ministers on 13 January 2003 in the House of Commons, John Bercow MP asked, in the light of ‘widespread and justified concern about companies which, in choosing to wind up their final salary schemes, universally [reneged] on their pensions obligations to their staff’, whether the Government’s proposals for reform of the MFR would lead to greater or lesser protection for scheme members.

4.531. A then DWP Minister, Maria Eagle, replied, referring to a then recent high-profile case, that such actions were currently lawful if ‘pretty disreputable by any standards’ and that the Government’s proposals would lead both to a more fair sharing of assets between the different categories of scheme member on wind-up and to enhanced protection for all members’ rights.

Revised Actuarial Guidance Note

4.532. Also on 13 January 2003, the actuarial profession issued a revised version (2.1) of their guidance note, Retirement Benefit Schemes – Minimum Funding Requirement, which made only minor technical changes to their guidance.

Parliamentary answer on scheme wind-up

4.533. On 11 February 2003, Ian McCartney, the then Pensions Minister, replied to a question from Frank Field MP, which had asked about the number of pension schemes then in wind-up.
4.534. The Minister replied that:

- during the period from 1 April 1997 to 31 March 1998, 24,974 pension schemes had completed wind-up (these schemes had 541,298 members);
- in 1998-1999, 7,388 schemes (with 165,572 members) had done so;
- in 1999-2000, the figures were 8,151 schemes with 343,365 members;
- in 2000-2001, the figures were 6,047 schemes with 158,118 members; and
- in 2001-2002, the figures were 4,388 schemes with 230,406 members.

4.535. He also said that, during each year, the figures for schemes (and members) who had notified OPRA that they were commencing wind-up were:

- in 1997-1998, 94 schemes with 9,485 members;
- in 1998-1999, 154 schemes with 5,732 members;
- in 1999-2000, 4,623 schemes with 107,397 members;
- in 2000-2001, 1,771 schemes with 76,156 members; and

4.536. On 27 February 2003, DWP published a report of research it had commissioned into the communication of information to scheme members.

4.537. The research examined how members of such schemes might react to the receipt of detailed information about the funding of their scheme. In particular, the focus of the research was on seeking to establish whether members would read and understand the information provided and what action, if any, they might be prompted to take as a result.

4.538. A sample of thirty people had been selected to receive a specimen letter, drafted by DWP officials, which related to a fictitious scheme. The letter set out the scheme’s funding position following a full valuation, the level of employer and employee contributions, an outline of the actuarial assumptions on which it had been based, and a description of what would happen should the scheme close with funding at its current level.

4.539. The key findings of the research were set out in a DWP press notice that accompanied publication of the report as being thus:

(i) that nearly all respondents said they would read such a document and several commented that it was clearer than other pensions material they had been sent about their own scheme;

(ii) that the general understanding of the document was reasonably good, including those sections relating to the funding position of the scheme. Nevertheless there was some confusion about the purpose of the document;

(iii) that several people did not understand what would happen to the money they had contributed to a defined benefit scheme. They thought they had an identifiable pot of money they could control and alter by, for instance, increasing their contributions if the scheme had a shortfall. It was not clear whether they would seek appropriate advice before taking such steps;

(iv) that the information about the circumstances under which the scheme might close had caused some concern and, for many, was new information; and
that a small number suggested such information might lead them to consider leaving the scheme. All of these respondents said they would consult someone first, but some said they would speak only to colleagues.

4.540. One of the topics covered in the face-to-face meetings with pension scheme members that formed part of this research was their understanding of scheme closure. Discussions with scheme members were organised around testing the participants’ understanding of messages in sample material which discussed three questions: ‘Is my pension guaranteed?’, ‘Why might the scheme close down?’ and ‘Will I get my full pension if the scheme did close down?’

4.541. It was reported, in section 7.1, that, while those who read the sample material ‘had no difficulties in understanding’ that the message was that their scheme could be closed, ‘this was new information for around half’ of the participants. With respect to the others, the report continued:

Some had witnessed their scheme closing to new members or were aware that this could happen but very few were aware that the scheme could actually be closed to active members. Several found this a worrying message:

... “What it states is that the pension is guaranteed so long as they are in existence unless they change the scheme. If it closes down before you retire you won’t get the amount you expect.
It is a worry – I don’t remember ever seeing anything like this in the documents I have read before.
It is very alarming because I didn’t think pension schemes could close down. I thought that it was law that all companies must have a pension scheme.”

4.542. Other comments made by participants in the research included that the material ‘lets you know that your pension is not 100% safe – something I’d never thought of before’ and that, if such information was provided with respect to an actual scheme, they ‘would try to get some information in writing as to the actual likelihood of the scheme closing down and what safeguards there are in place’.

4.543. When material was shown to participants that indicated that, were a scheme to wind-up not ‘fully-funded’, they might not receive their own personal full entitlement, the research reported that ‘many active members were concerned by this... and a good number felt that they would be angry if they received such information about their own scheme’. The report continued:

The respondents who stated that they would be angry were those who did not comprehend how such a situation could have come about... they felt that if they did not receive their full entitlement then they would have been ‘robbed’ by their employer. Some simply felt it could not possibly be the case that they would not receive their full entitlement if their own scheme were to close down.

“It is just rubbish. You have built up the fund and you are guaranteed the pension because of your years of service and for an insurance company to say that they have lost money because they are incompetent and the fund hasn’t made the money it should do – that’s not my fault and I shouldn’t be penalised.”

4.544. The research report came to some ‘key points to consider’ about this material. These included:

(i) that ‘discussing circumstances whereby schemes may close can alarm people and this can become the central message that
they take from the document. The alarm partly comes from their lack of knowledge about the possibility that schemes can close;

(ii) that it is 'difficult to communicate to members that their pension is not fully guaranteed. This may serve to galvanise people to check on how their schemes are performing but it may also alarm some and/or lead them to take action that is not necessarily in their best interests'; and

(iii) that 'discussion of how much of the accumulated pension that a member might expect should the scheme close may encourage members to consider supplementary investments'.

Letter from actuarial profession
4.545. The new Chairman of the Pensions Board of the Faculty and Institute of Actuaries wrote to DWP on 28 February 2003. In his letter, the Chairman said:

We last proposed amendments [to the MFR basis] in September 2001 and in the following February the Government approved a change to the basis in GN27. The main driver for recommending a weakening of the MFR at this time was a reduced level of the non-payment of dividends. The extent of this weakening was, however, mollified by an allowance for improvements in mortality.

Since then, MFR has weakened substantially. This is mainly as a result of falling stock markets. We believe that further changes are now needed if the Government wishes to align the MFR more closely to the level of protection originally envisaged. The strength of the MFR is a decision for Government...

Our advice is that retaining the MFR at its current strength in the meantime [i.e. prior to the replacement of the MFR] would represent materially less security of members’ benefits, especially where schemes are funded at the MFR minimum level, compared with the security implicit in the MFR when it was originally introduced.

Revised DWP guide to pension options
4.546. In April 2003, DWP issued a revised version of their leaflet PM1 – ‘a guide to your pension options’ (see entry for July 2001).

4.547. In the section that dealt specifically with occupational pensions, the revised guide repeated the first part of the earlier edition but then, in a new second paragraph, set out amended text which advised:

Occupational pensions are usually a very good deal, so if your employer runs an occupational pension scheme, check it out carefully when you are looking into your pension options.

4.548. In a new section, entitled ‘keep an eye on your pension arrangements’, the revised guide went on to explain that:

...you need to keep an eye on your pension arrangements regularly to make sure you will have the income you want when you retire. If you become better off, you may want to pay in more to build up your pension.

4.549. The revised guide then explained that, in such a position, an individual might make additional voluntary contributions to their occupational scheme or to another scheme, change to a stakeholder pension to take advantage of tax concessions, or make additional contributions to other savings vehicles.

4.550. The revised guide repeated the text about ‘other things that could affect your pension’ that had been set out in the earlier edition.

4.551. In a new addition to a section entitled ‘what do I need to do now?’, the revised guide included a statement that ‘if your employer offers access to an occupational scheme, it is usually worth joining’.
4.552. In addition to the sources of information set out in the earlier edition, the revised guide signposted readers to FSA consumer publications. As with the earlier edition, on the back cover of the leaflet, it was stated that ‘this leaflet is for guidance only: it is not a complete statement of the law’.

**Revised DWP guide to occupational pensions**

4.553. DWP at the same time also issued a revised edition of their leaflet ‘occupational pensions: your guide’ (PM3). The only relevant substantive changes to the text from the earlier edition (see above) were in the updating of possible sources of information and advice.

**DWP guide to contracting-out**

4.554. DWP also published in April 2003 a leaflet (PM7) called ‘contracted-out pensions – your guide’.

4.555. In the section dealing with final salary schemes, after explaining that the rules related to Guaranteed Minimum Pensions had been changed, the guide said ‘any GMP that you built up before April 1997 will still be paid when you retire, but pension entitlement you earned from that date will be assessed and paid under the new rules’.

4.556. In a section entitled ‘what else do I need to think about?’, the guide explained the tax relief provisions and the possible effects of living abroad when a person retired. It ended with a list of other official publications or organisations that might be helpful.

**Government response to second Green Paper**

4.557. On 11 June 2003, DWP published a White Paper or ‘action plan’ – ‘Working and Saving for Retirement: Action on Occupational Pensions’ – which set out its proposals, following the consultation on the most recent Green Paper on pensions (see above), to drive forward its agenda of ensuring that individuals could ‘plan for their retirement and make real and informed choices’ about work, saving and pensions.

4.558. The document set out its proposals for the improvement of member protection thus:

The Government will protect consumers and improve the future security of pensioners by:

(i) introducing a Pensions Protection Fund to guarantee members a specified minimum level of pension when the sponsoring employer becomes insolvent;

(ii) requiring solvent employers who choose to wind up their pension schemes to meet their pension promise in full; and

(iii) revising the priority order which applies on wind-up to ensure the fairest possible sharing of assets.

In addition, the Government will introduce new protection to deal with anxieties arising from the demands of an increasingly dynamic economy where companies are taken over and people move between jobs more frequently.

We will:

- increase protection when firms are bought out by extending the protections offered by the Transfer of Undertakings (Protection of Employment) regulations to the pension schemes of workers in the private sector;
- help people build up rights in short-stay jobs by introducing a new approach to vesting. At the moment, rights are only protected after two years’ employment;
- in future, employees who have been scheme members for at least three months and leave during the vesting period will be offered the choice of a refund of contributions or a Cash Equivalent Transfer Value. This will be of
particular benefit to women, who are more likely to change or leave jobs during the period; and

- introduce a requirement on employers to consult before making changes to pension schemes to ensure changes are developed in partnership.

The Government will introduce a new system of private pension regulation with a new Pensions Regulator. The new Pensions Regulator will concentrate on rooting out fraud and bad practice so that everyone has confidence in the system. It will do so in a way that supports our objectives of simplicity and reduced burdens on business.

4.559. In relation to ‘making pension provision easier for employers’, the document reaffirmed the Government’s commitment to replacement of the MFR with a scheme-specific funding arrangement. It also set out proposals to reduce the cap on mandatory indexation, to increase the scope for flexibility for schemes to rationalise the structure of their benefits, and to simplify the legislative framework.

4.560. The Government said that in parallel it would be taking steps to enable people to ‘make their own decisions about how and when to save’.

4.561. The press notice which accompanied publication of the document quoted the then Secretary of State for Work and Pensions, Andrew Smith, as saying:

We have listened to the pension scheme members, employers and the pensions industry – and it is now time for action. This balanced package strengthens protection for scheme members whilst reducing the burden on companies who run schemes. The new Pension Protection Fund will ensure that, where company pensions have been promised, pensions will be delivered. I want to end the scandal of workers being denied the pensions they have built up over many years, or pensioners seeing their pension cut if their firm goes bust and their scheme winds up.

4.562. In his statement to the House on the same day, Mr Smith said that:

...examples of good practice are too often overshadowed by cases where employers have gone back on promises, causing anxiety. People also worry about the get out clause which lets solvent companies – who could afford to keep their pension scheme running – wind it up with inadequate compensation.

In the cases where firms have done this, it has inflicted damage on confidence in the whole system. People worry that other schemes will follow suit.

We need to act to make sure that a pension promise made by employers is a pension promise honoured by employers. We will therefore strengthen member protection where solvent employers decide to wind up their pension scheme...

Sometimes – when firms go bust – the money isn’t there to meet pension commitments. Recent cases have shown the terrible injustice when this happens, and I believe the public are right to demand action. We should not accept that just because a firm goes out of business workers can find that a pension they’ve saved in for all of their working life is worth next to nothing.

Parliamentary questions on the MFR

4.563. On 14 July 2003, Malcolm Wicks, the then Pensions Minister, replied to a question from Oliver Heald MP, who had asked what changes had been made to the basis for the MFR since May 1997 and what effect such changes had had on the demonstrated level of funding of a typical pension scheme.
4.564. The Minister replied:

The actuarial basis for the MFR is kept under review by the Faculty and Institute of Actuaries. They have recommended two substantive changes to the basis since May 1997, and both were implemented.

From 15 June 1998 the factor for the equity market value adjustment, which generally applies to the calculation of liabilities for scheme members below pension age, was reduced from 4.25 per cent to 3.25 per cent and the gross yield on the FTSE Actuaries All-Share Index was replaced with the net yield on the same index.

From 7 March 2002 the factor for the equity market value adjustment was further reduced, from 3.25 per cent to 3.00 per cent.

The changes were intended to address movements in the strength of the MFR test resulting from changing economic and demographic trends. In addition to these changes there have been a number of minor technical amendments to the actuarial guidance which governs the calculation of a scheme’s MFR liabilities.

It is not possible to define a typical pension scheme, but estimates about the effect of these changes on the aggregated MFR funding levels of all schemes subject to the MFR have been prepared by the Government Actuary’s Department. These indicate that the change which took effect from 15 June 1998 may have increased aggregate funding levels against the MFR by around 5 per cent and that the change which took effect in March 2002 may have further increased aggregate funding levels against the MFR by around 3 per cent.

4.565. In reply to another question by Mr Heald, the Minister said that, as at June 2003, it was estimated by the Government Actuary that 50% of schemes were funded below 100% MFR level and that this equated to an aggregate £30 billion shortfall. He continued that, if judged against the MFR basis that had existed in May 1997, the respective figures would have been 75% and £60 billion.

**OPRA update on winding-up**

4.566. On 18 August 2003, OPRA published its ‘update 3’ on winding up. Aimed at trustees, advisers and insolvency practitioners, the update set out OPRA’s views on the issues that often arose during the winding-up process. These included defining when wind-up began, investment issues, MFR valuations, defining and certifying scheme deficits, cash equivalent transfer values, GMP equalisation, employer insolvency, and the appointment of independent trustees.

**Revised OPRA guide to the MFR**

4.567. In October 2003, OPRA issued a revised version of its guide to the MFR (see the entry for May 1999, above).

4.568. In the revised section ‘about the MFR’, the guide stated that ‘the MFR is not, however, a guarantee of members’ benefits. It is not intended to ensure that members’ benefits will be met in full if the scheme is wound-up’.

4.569. Page 31 of the revised guide introduced a new section called ‘what if the scheme goes into wind-up?’ After explaining the role of trustees during the winding-up process, the guide continued:

If a scheme in wind-up is under-funded, trustees may need to instruct the scheme actuary to formally certify the amount of the under-funding as a debt on the employer. This may not be necessary if the employer is solvent and makes adequate funds available to the scheme to enable benefits to be fully secured.

Once the amount of the under-funding is certified, it then becomes a formal debt on the employer and the trustees should consider taking action to enforce it.
4.570. The guide warned:

_However, if the employer is insolvent, the debt is not a preferential debt and it only ranks with debts owed to other unsecured creditors of the employer. This means that the debt may be unlikely to be paid in full and the amount of money the trustees will receive from the employer will depend on the extent of the employer’s liabilities when it became insolvent._

**Government announcements on GMP and priority order**

4.571. On 20 October 2003, the then Secretary of State for Work and Pensions, Andrew Smith, announced in the House that the Government intended to introduce measures to permit contracted-out final salary schemes to convert Guaranteed Minimum Pension entitlements into scheme benefits on the basis of actuarial equivalence.

4.572. Two days later, Malcolm Wicks, the then Pensions Minister, made a written statement concerning the priority order for the distribution of scheme assets on wind-up. It read:

_Today we have published proposals to amend the statutory priority order when a defined benefit pension scheme subject to the minimum funding requirement is wound up and draft regulations to bring these proposals into effect._

_The draft regulations are intended to ensure that, where there are insufficient assets to meet all liabilities, they are shared as fairly as possible between non-pensioner and pensioner scheme members._

_As outlined in “Action on Occupational Pensions” the degree of protection offered by the new priority order reflects the length of time a member has been contributing to a scheme and also gives priority to the rights of non-pensioners over the future indexation of pensions in payment._

We are consulting on the draft regulations and proposed new priority order and should welcome views on both by 3 December 2003. We aim to lay these regulations by early 2004 so that they come into force as soon as practicable.

**Consultation on EC Directive**

4.573. On 28 October 2003, DWP published a consultation document on its proposals to implement the EC Directive on Occupational Pensions. The Directive required the implementation of a ‘prudent person’ approach to investment, competent regulation by a public authority, measures to oversee cross-border activity by pension schemes, the disclosure of information to scheme members, and that final salary schemes should hold ‘sufficient and appropriate assets’ to cover accrued liabilities and to adopt a recovery plan if there were under-funding.

**Early Day Motion**

4.574. On 3 December 2003, Kevin Brennan MP tabled an Early Day Motion, which in due course attracted 300 signatures from Members of Parliament. The motion stated:

_That this House acknowledges the plight of workers who have lost their final salary occupational schemes through company insolvency despite being promised by firms and successive governments that their pensions were guaranteed and in many cases having been compelled to join their scheme as a condition of employment; further believes that the Government has a moral and possibly legal obligation to help those workers who have been stripped of their pensions through no fault of their own; and further calls upon the Government to introduce legislation to compensate victims of this singular injustice._
Parliamentary question on contributions holidays

4.575. On 8 December 2003, Malcolm Wicks, the then Pensions Minister, was asked by Shaun Woodward MP what plans the Government had to review the policy of unlimited pension contribution holidays in final salary pension schemes.

4.576. He replied:

Since pension provision by employers is voluntary, the levels of contributions are a matter for agreement between pension scheme trustees and sponsoring employers.

Under the new scheme-specific funding regime, which is intended to replace the Minimum Funding Requirement, trustees and sponsoring employers will be required to develop and agree, with the scheme actuary’s advice, the funding principles for their scheme – including a determination of whether the level of contributions is sufficient to meet a scheme’s long-term pension commitments.

The new proposed, simpler tax regime for approved pension schemes (set out in the document “Simplifying the taxation of pensions: increasing choice and flexibility for all” (December 2002)) would abolish the rules requiring approved occupational pension schemes to run off their surplus funds (for example by agreeing contributions holidays) or lose their full tax-exempt status. In addition, the document “Action on Occupational Pensions” announced that pension funds will be able to make payments to employers from an actuarial surplus only where the scheme is funded above a level sufficient to secure full buy-out of scheme liabilities.

Informed Choices for Working and Saving


4.578. The document noted that the Government was ‘committed to opening up options for people to extend their working lives and to ensure that people have sufficient information to plan and to provide for their retirement’. It then set out the three elements of its proposed ‘Informed Choice Strategy’: the activation of the current system to maximise provision and to ensure that everyone had access to ‘good choices’; the continuation of work with the FSA to raise overall levels of financial education and awareness of the need to plan and to provide for retirement; and further work to ensure that all people of working age had access to personalised information to help them understand how the choices available to them related to their own retirement prospects.

4.579. The document lamented a position where:

...there are still too many people who, because of a lack of understandable and trusted information, do not engage with the choices they have, and, as a consequence, make no choice at all. This is a very high-risk approach. We believe the public will be better served by a more fail-safe system where people do not cut themselves out of a pension scheme by inertia alone.

4.580. After reiterating that ‘for most people, their employer’s pension scheme is the best form of saving for retirement’, the document continued by setting out three options to change pension schemes to increase employee membership and contribution, on which further views would be sought.

4.581. In relation to the raising of awareness and developing financial education strategies, the document said:

It is key that the Government and its agencies work together to provide education appropriate
to people’s needs at different points in their working lives. We want to move to a position where people approaching retirement are better informed about the choices they face. For example, their options around when to retire, opportunities for flexible working, or the timing and nature of annuity purchase, as well as understanding the implications of those choices on their potential retirement income. We want all people of working age who are contemplating career breaks, working part-time or retiring early to be better informed about the implications for their pension saving.

4.582. The document then noted the Government’s recognition that DWP ‘can do more to provide better information’ and then set out proposals for an integrated retirement planning service, which would include improved marketing based on ‘leaflets giving information on all types of pension and the services government and others offer to support people in making choices’.

4.583. Chapter 4 of the document was entitled ‘giving people the right information’. It began by stating that:

We want to make sure that people get the right information at the right time, in the right way. Many people say that they want to plan for retirement but do not know where to start. There is a lot of information available to individuals about pensions and retirement planning. This quantity of information can be confusing and some individuals will not necessarily trust it. Individuals may not always be able to understand whether the information is impartial or is geared to marketing a particular product or group of products.

We know that people want help from an impartial source they can trust which is specifically about their own status, prospects and options. We think that personalised information makes a difference and prompts people to think about their retirement planning.

4.584. It continued:

We are keen to ensure that all of our communications are as clear and effective as possible. Therefore, we propose to commission new research on effective pension communications. This will help us to further improve our messages and ensure we get the right information, to the right people in the right way.

4.585. The document concluded by stating the Government’s view that their strategy would ‘help to renew further the pensions partnership between government, employers, individuals, the financial services industry, trade unions and the voluntary sector. These measures will help to empower individuals to make their own decisions about retirement and the level of income they want in retirement’.

4.586. In the press notice which accompanied publication of the document, the then Secretary of State for Work and Pensions, Andrew Smith, was quoted as saying:

I have met with many employees and employers who have said that it is the quality and relevance of information that is crucial in allowing them to take key decisions about their pension. I believe that through this package of measures we will have taken a major step towards changing people’s attitudes towards their pension and helping them plan properly for their retirement.

Publication of Pensions Bill

4.587. The draft Pensions Bill, designed to enact the Government’s reform agenda and to consolidate existing legislation, was published on 12 February 2004.
4.588. The then Secretary of State was quoted in the press notice which accompanied publication of the Bill as saying:

Where companies with under-funded pensions have gone bust, workers have found themselves severely short-changed on the pension they were expecting. With the Pension Protection Fund, people in pension schemes can be much surer that they will get the pension they were promised. The Fund will be complemented by a flexible Pensions Regulator which will make it easier for businesses to get on with running good pension schemes. It will focus on the under-funding, fraud and maladministration that can threaten members’ benefits, whilst minimising interference for well run schemes.

Parliament begins consideration of the Pensions Bill


4.590. In the Commons Standing Committee debate on 23 March 2004 on the proposed replacement of the MFR, Malcolm Wicks, the then Pensions Minister, said, in response to a request from the Official Opposition spokesperson to explain why the MFR basis had been changed twice:

The hon. Gentleman also asked why the Government have twice cut the value of the MFR, in 1998 and 2002. I am bound to say that this is a highly technical arena that concerns the actuarial basis for the MFR, which has, as he said, been adjusted twice. The relative strength of the MFR test is affected by a range of factors, including economics and demography and covering issues such as longevity, changes in yields from equities and other investments, which were mentioned, and changes in the costs of buying annuities and deferred annuities. Perhaps it is inevitable that such factors will change over time and, therefore, the strength of the MFR will fluctuate relative to prevailing market conditions.

4.591. The Minister continued:

The Faculty and Institute of Actuaries monitors the actuarial basis for the MFR, with a view to recommending changes when appropriate. That basis was adjusted in 1998 and 2002, following its recommendations, because the MFR was operating at a higher strength than originally intended. As I said, those changes represented technical adjustments, which were recommended by the actuarial profession and were intended to realign the MFR closer to the strength that was originally intended. They did not involve any change in policy regarding its strength. These are profoundly difficult matters. Although one is occasionally tempted into partisanship, it is normally sensible to listen to what the actuarial profession advises.

4.592. In response to a further question from Nigel Waterson MP, for the Official Opposition, who had asked whether he accepted that those who had lost out on their pension rights would have had more to show had the changes to the MFR basis not been made, the Minister said:

Hindsight is a wonderful thing. All I can say is that that was the recommendation of the Faculty and Institute of Actuaries at the time and it was sensible of the Government of the day to follow that advice. It all adds up to us – not just the Government, but to others, too – thinking that we need to move ahead in a different direction, hence the proposals that we are discussing today about scheme-specific funding.

4.593. Pressure continued to mount during parliamentary scrutiny of the Bill to do something to provide compensation to those who had suffered due to scheme wind-ups. In Prime Minister’s Questions on 21 April 2004, in
response to a question from Tony Lloyd MP, Mr Blair said:

...we are actively considering the position of people who, having been forced to contribute to occupational pension schemes, find that all the money that they have invested yields absolutely nothing. We are examining what we can do in such special cases, and, in the context of the current debate on pension protection issues and legislation, I hope that we can come forward with the solution.

Publication of revised DWP guide to contracting-out


4.595. In a new section called ‘what happens if a contracted-out salary related scheme has to wind up?’, the guide first explained the circumstances in which schemes might wind up. It continued:

When a salary-related scheme winds up, the trustees of the scheme have to pay what is owed to scheme members using the scheme’s current funds (or assets). Sometimes there may not be enough funds to do this. When this happens, any shortfall becomes a debt the employer owes the scheme...

But there is still a chance that you may get less than you expect if your salary-related scheme winds up. That is why the Government has announced its plan to introduce a new Pension Protection Fund and a new pensions regulator.

4.596. The guide then explained the role of the PPF and the new regulator, before informing the reader that, if they wanted to find out more about the protection of their pension during wind-up, they could talk to scheme trustees or an authorised financial adviser.

Further revision of DWP guide to occupational pensions

4.597. Also in April 2004, DWP issued a further revision of their leaflet ‘occupational pensions: your guide’ (PM 3 – see above).

4.598. The principal revisions of relevance to this report were:

(i) the renaming of the section that formerly asked ‘how do I know my money is safe?’, which now became ‘is my money protected?’; and

(ii) the inclusion of a new section called ‘what happens if a salary-related scheme has to wind up?’

4.599. The latter section, which it is worth here quoting in full, said:

Winding up is the process of ending an occupational pension scheme. This may happen for a number of reasons depending on a scheme’s rules. For example:

(i) an employer may decide to stop contributing to a scheme;

(ii) an employer may become insolvent and this may lead to the scheme being wound up; or

(iii) the scheme’s trustees may decide to wind up the scheme.

4.600. It went on:

When a salary-related scheme winds up, the trustees of the scheme have to try to pay what is owed to scheme members using the scheme’s current funds (or assets). Sometimes there may not be enough funds to do this.

When this happens any shortfall becomes a debt the employer owes the scheme. This allows trustees to take action to chase the debt. Regulations also make sure that assets are shared out as fairly as possible. Some unpaid
contributions can be claimed when employers become insolvent. And, in certain circumstances, members may have some or all of their SERPS or State Second Pension restored for the period they were contracted-out. All of this helps to protect the pension that you have built up. But there is still a chance that you may get less than you expect if your salary-related scheme winds up.

4.601. The guide continued:

That is why the Government has announced its plan to introduce a new Pension Protection Fund and a new pensions regulator. The Pension Protection Fund will pay compensation to scheme members when an employer becomes insolvent and there are not enough assets in the scheme to pay the Pension Protection Fund level of benefits. The Pension Protection Fund level of benefits is broadly equal to the amount of compensation that would be paid by the Pension Protection Fund. For most schemes this will be based on 100% of benefits to those over the scheme’s normal pension age and 90% of benefits to members below the scheme’s normal pension age. However, there will be a limit on the benefit that can be paid.

The new pensions regulator will focus on protecting the benefits of scheme members by concentrating on schemes if it considers that there is a high risk of fraud, poor management, or poor administration. If you want to find out more about how your salary-related pension is protected during winding up, you can contact your scheme’s trustees. If you are in any doubt about your position, you can also contact an authorised financial adviser. But, remember, if you do see a financial adviser, you may have to pay for their advice.

GAD survey on occupational pensions

4.602. Also in April 2004, the Government Actuary published his twelfth in a series of surveys of occupational pension provision in the UK that had been undertaken by his Department since the 1950s.

4.603. In Chapter 8 of the survey, which was a new addition and contained analysis of those schemes which were winding-up at that date, the Government Actuary said that there were around 470,000 members of schemes in wind-up, of which approximately 120,000 were existing pensioners and 70% of the total membership were in final salary schemes.

4.604. It also said that approximately 230,000 people (both pensioners and those yet to retire) were in final salary schemes where the sponsoring employer was insolvent.

4.605. Paragraph 8.5 of the survey noted that only 78% of its respondents who were winding-up had notified OPRA that they were so doing.

Reform of the priority order

4.606. On 19 April 2004, Regulations were laid before Parliament to reform the statutory priority order in which the liabilities of a scheme must be discharged on wind-up by placing the rights of non-pensioners before increases for pensions in payment. This reform would have effect from 10 May 2004.

Announcement of Financial Assistance Scheme

4.607. On 14 May 2004, Andrew Smith, the then Secretary of State for Work and Pensions, announced that the Government would be providing £400 million of public money, to be paid over 20 years, to create a scheme to provide ‘assistance’ to some of those who had lost part or all of their pension rights due to their scheme winding up under-funded.

4.608. In a BBC radio programme, Money Box, that was broadcast on 15 May 2004, Malcolm Wicks, the then Pensions Minister said, in relation to the proposals to establish a ‘financial assistance scheme’ that those proposals were ‘a major step forward that we’ve announced this
week in terms of helping this group of people, they’ve effectively had their money stolen from them and through no fault of their own and we think it’s right that the public should support them and that’s what we’re going to do.’

4.609. During further consideration of this proposal, Mr Wicks said in the House of Commons on 19 May 2004 that:

The pension protection fund is a major social policy advance that will bring protection and security to more than 10 million pension scheme members and their families... but it is overshadowed by a cloud – the plight of the tens of thousands of workers who have already lost their pension rights or a large percentage of them, which is debilitating for those affected and underpins confidence in the idea of saving for a pension.

4.610. Mr Wicks continued:

Most of those people expect to receive a much reduced pension. I have been deeply moved, as we all have, by the distress and bewilderment of many people who, after long years of paying into a pension scheme, have been told that, after all, the pension they are relying on, and which they have paid for, will not be there.

4.611. The Minister then went on to formally propose an amendment to the Bill that would provide for the establishment of a ‘financial assistance scheme’ to ‘assist people who have lost out severely as a result of the winding-up’ of an ‘under-funded’ scheme which would not be covered by the PPF.

4.612. He explained:

The Government have put forward £400 million over 20 years to help address the serious losses that some now face. It is open to industry to offer further support. We hope that that support will be forthcoming. This money will not cover everyone who feels aggrieved, nor will it give those it does help everything they might want, but it represents significant help to those who have lost the most.

4.613. The Minister went on to say that:

The coverage must ensure that those suffering losses are helped according to the principles of openness, fairness and, very importantly, operational practicability. The role of the industry, employers, actuaries, trustees and trade unions in resolving those issues is as great as that of the Government... I would like briefly to take the House through how we intend to turn our commitment into reality. It involves four phases of work: first, we shall engage with our partners and industry experts, including the trade unions; secondly, we shall design the detail of the policy and the operational framework; thirdly, we shall prepare to implement the scheme; and, fourthly, we shall go live and make payments.

Pensions Information Pack

4.614. DWP launched a new pensions information pack for employers and employees on 29 June 2004, which had been devised by the Association of British Insurers.

4.615. At the launch event, the then Financial Secretary of the Treasury said:

Informed choice is an essential part of the Government’s strategy, reaffirming the essential partnership in pensions between employers, employees, providers and the Government. It builds on the work we are doing to increase protection through the Pensions Bill and the simplification of the pensions tax system.

DWP research on schemes affected by wind-up

4.616. On 30 June 2004, DWP published research it had undertaken to establish the number of people affected by pension schemes which had wound up under-funded since 1997 with insolvent sponsoring employers. The report
provided estimates based on information gleaned from trustees responsible for winding-up the relevant schemes.

4.617. It reported that:

(i) the number of people facing losses of 20% or more of their pension totalled 75,000;
(ii) the number who faced losses of 30% or more were 70,000;
(iii) the number who faced losses of 40% or more were 60,000; and
(iv) those who faced losses of 50% or more numbered 40,000. This included 35,000 people who were facing losses of more than £5 per week.

4.618. The research did not cover those in solvent employer schemes who might be facing similar losses.

4.619. In the press notice which accompanied publication of this research, Andrew Smith, the then Secretary of State, was quoted as saying:

...for the future our new Pension Protection Fund will provide cover to ensure that even where a firm goes bust employees can still be sure they'll get a worthwhile pension. The £400 million scheme for those who have already lost out is another step that will help to boost confidence in occupational pensions and I hope industry will play its part in that by making a contribution to the scheme. We hope to have the legislative framework of the scheme in place by spring of next year and making payments as soon as it’s practical.

**OPRA update for under-funded schemes**

4.620. OPRA published its ‘update 9’ on 26 August 2004, which provided information about its expectations in the light of the announcement of the FAS. It urged trustees of schemes in wind-up to advance the process so that the relevant liabilities could be determined as soon as possible.

**Early Day Motions and parliamentary questions**

4.621. On 11 October 2004, the Government reiterated, in response to a parliamentary question, that it would have the legislative framework in place for the FAS by Spring 2005 and that it hoped to make payments from the FAS as soon thereafter as was possible.

4.622. Sandra Osborne MP tabled an Early Day Motion on the FAS on 23 November 2004, which subsequently received 158 signatures from Members of Parliament. It read:

That this House recognises the suffering of those members of final salary schemes who have lost their pensions when their schemes were in wind-up and their need for urgent assistance; welcomes the provision of £400 million for the Financial Assistance Schemes but is concerned that this is not a sufficient sum to provide the substantial assistance promised by the Government; asks the Government to consider pooling the assets of winding-up schemes, rather than purchasing annuities, and paying pensions on an ongoing basis, as will be the case with the Pension Protection Fund, so that costs to the Exchequer can be spread over a long period of time which would provide an affordable option without overburdening the public funds; notes that if the Financial Assistance Scheme lasts 20 years those people currently in their fifties will only be in their seventies when the Scheme runs out; further notes that estimates suggest that if the Government will commit to pay a sum of £75 million a year, index linked, for 40 years into a central fund and pool all the assets of the schemes which have not yet bought annuities, promised pensions to non-retired members could be paid to at least the level of the Pension Protection Fund; calls on the Government to acknowledge that further resources will be
required to fulfil the Government’s desire to rectify this injustice and restore confidence in pensions; and finally urges the Government to settle this matter as soon as possible and in advance of a general election.

4.623. Two days later, David Willetts MP tabled another Early Day Motion on the FAS, which in due course received 91 signatures from Members of Parliament. It read:

That this House welcomes the creation of the Financial Assistance Scheme; notes with concern that people who have already been affected by the wind-up of a pension scheme do not know whether they will be eligible for assistance, what level of assistance they will receive, or when assistance will commence; is very concerned that £400 million will not provide the level of assistance that many might be expecting; calls on the Government to reveal details of the scheme at the first possible opportunity; and urges the Government to consider using unclaimed assets to boost the funds available for assistance.

4.624. On 29 November 2004, the Government confirmed, in response to a parliamentary question, that the FAS would be funded out of existing spending commitments from April 2005 to March 2008. For later years, the Government said it would take account of their commitment to the FAS in future spending reviews.

4.625. As part of a series of answers to parliamentary questions given on 6 December 2004, DWP Ministers stated that the Government did not accept that they had any liability for the losses that had been or would be incurred by scheme members due to the winding-up of their scheme without sufficient funds to meet all liabilities.

**FAS eligibility and Royal Assent for the Pensions Act 2004**

4.626. In the meantime, on 12 November 2004 DWP had issued a press notice regarding the FAS, shortly after it had announced the eligibility criteria for assistance from the PPF. This stated that work to determine eligibility for the FAS continued.

4.627. On 18 November 2004, the Pensions Act 2004, which incorporated provisions for the establishment of both the PPF and the FAS and the replacement of the MFR, received Royal Assent. The previous day, the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Amendment Regulations 2004 had been made by the Secretary of State and were laid before Parliament on 23 November 2004. These Regulations came into force on 21 December 2004.

4.628. On 2 December 2004, Malcolm Wicks, the then Pensions Minister, made a further announcement about eligibility for the FAS. He said:

Since the Financial Assistance Scheme was announced in May we have made good progress in scoping what is an extremely complex problem, involving hundreds of pension schemes, with differing scheme rules and in different stages of winding up. Following an initial data-gathering exercise, we laid a report before the House in June, setting out an estimate of the numbers affected.

Ministers and officials have since consulted with scheme members, trade unions and industry experts to gather and analyse more data, and explore options for the best way to get assistance to those who need it most.

Obviously, the full extent of the problem can be known only once all potentially eligible schemes
have been identified and information obtained on the individuals affected and the extent of their losses.

In September, we launched a second, more detailed data-gathering exercise to identify potentially eligible schemes. It is important that all scheme trustees and actuaries who think their schemes might be eligible respond by 10 December. Data-gathering on the position of individuals will follow.

While we continue to seek industry contributions to the Financial Assistance Scheme, full participation in this exercise is an immediate opportunity for the pensions industry to provide valuable practical help and assistance in kind.

4.629. He continued:
As we have previously said, the scheme will not give everyone all of what they want. Nor will the scheme provide the same assistance levels as the pension protection fund, which provides cover going forward, funded by a levy. The primary objective is to provide significant help to those who have lost the most.

The available funding is set. People who are younger have more time to work and save for a pension to replace one that has been wholly or partially lost. Therefore we are minded to gear assistance levels with reference to the number of years an individual is from their retirement. To further focus resources, we are considering making payments for all individuals at age 65.

The pension protection fund has a benefit cap for those below scheme pension age, and it makes sense that the FAS should also have one, which we intend to set at a lower level.

4.630. Mr Wicks went on:
To minimise bureaucracy and to maximise payments to those facing the most serious losses, Ministers intend that, other assistance criteria aside, the FAS will include only those who will receive at least £10 a week, or equivalent, from the scheme.

Information already gathered makes clear that the vast majority of those that had started winding up with significant funding shortfalls did so after January 1997. We can therefore confirm that members of schemes that commenced winding up from 1 January 1997 will potentially be eligible, subject to the other FAS entry rules. Schemes starting to wind up right through to the introduction of the pension protection fund (6 April 2005) will also be potentially eligible.

Solvent employers have a duty to support their schemes and provide the benefits that members were expecting. So, it is right that the FAS focuses on insolvent employers. Nevertheless, issues concerning the definition of “employer solvency” remain under active consideration.

Those who have lost out due to their scheme winding up under-funded have already seen their expectations for retirement upset once. It is therefore important that the resources available for FAS are deployed in a way that ensures that any new promise made to those eligible will be delivered. This points to providing assistance by means of top-up to the occupational pension that individuals would otherwise receive. Trustees should therefore fulfil their duty to wind up schemes in an expeditious manner, including annuitisation where appropriate. We will consider further the precise means of delivery – options include a top-up pension, a cash lump sum, or purchase of an annuity at age 65.

4.631. He concluded:
Early next year we would hope to be in a position to announce what we propose by way of indicative assistance levels to those facing the most urgent difficulties, as well as an indicative
list of schemes that are likely to be eligible for assistance if those schemes are subsequently shown to comply with the FAS rules.

The complexity of the issue, the amount of data that has had to be collected, and the level of consultation undertaken, means that the formal regulatory consultation will begin in the spring.

In April we will set up the body to administer the scheme and following the formal consultation we will lay regulations before Parliament, making payments as soon as practicable thereafter.

4.632. In response to a parliamentary question on 20 December 2004, the then Pensions Minister confirmed that no assessment of an average payout to affected scheme members had underpinned the Government’s decision to make available £400 million to the FAS.

4.633. A further announcement about FAS eligibility was made on 22 February 2005. The written statement to the House said:

In December 2004 we said that our priority was getting help to those facing the most urgent difficulties being closest to, or already at, retirement age and therefore less able to make provision to replace their lost pensions.

At that time we had asked independent trustees to provide data on the pension schemes that they thought might be eligible for the financial assistance scheme. We had a very good response and from the information provided it appears that there are at least 380 schemes in which members might be potentially eligible for financial assistance. The precise scale of the financial shortfalls in these schemes cannot be known until the winding-up processes are close to completion.

4.634. It continued:

A list of these potentially eligible schemes has been placed in the Library. It is a provisional list which broadly confirms earlier estimates of the scale of the problem, and the number of individuals affected. The detailed eligibility criteria for both schemes and members will be set out in regulations that we expect to publish for wider consultation in the spring. Once finalised these will need parliamentary approval, which we hope to obtain by the end of July.

As solvent employers have a duty to support their schemes and provide the benefits members were expecting, it is right that the FAS focuses on insolvent employers. We expect employers to stand by their pension promise to their employees, and will take a dim view of the solvent employer who seeks to avoid their responsibilities to their employees or the employees of a company for which they have been a parent company. We have consulted widely on how we should define “employer insolvency” and concluded that for FAS purposes we should have a sufficiently general definition of insolvency to capture schemes where the sponsoring employer no longer exists and also where insolvency may have occurred some time after scheme wind-up had started. This definition will be similar to that used by the PPF but with the additional inclusion of some companies which have undergone members’ voluntary liquidations – where a declaration of solvency was made at the time of wind-up but where the company is now no longer solvent and so no employer exists to support the scheme.

We are minded to judge the insolvency position for multi-employer schemes on the principal employer of the scheme.

4.635. The statement continued:

The list contains those pension schemes on which we received information in the latest data collection exercise and which, from the information provided by trustees, appear potentially eligible under the criteria set out
above. The list provides an early indication of scheme eligibility for members of the schemes we have been told about. But I need to make clear a number of caveats. First, it will take time to establish the final position, but as wind-up progresses we will become clearer on the size of the gap between assets and liabilities of these schemes. Second, presence on this list does not guarantee individuals will receive support from the FAS. Third, it does not mean trustees should stop their duties of securing the best possible outcome for their scheme members.

After the FAS regulations have come into force, there will be a six-month period during which we shall accept formal notification from the independent trustees of other under-funded pension schemes, which may in due course be added to the list, so absence from this list does not preclude eligibility.

Whilst we have sought industry contributions, it is very disappointing that no financial contribution has been forthcoming. As a result the available funding stands at £400 million over 20 years, which the Government have committed on behalf of the taxpayer.

4.636. The statement went on:

As we have explained before, in many cases the trustees are not yet able to provide detailed information on the scale of individual losses and in practice this may not be available until they are close to completing the winding-up of each pension scheme. But those scheme members who have already retired or expect to retire within the next few years need to know where they stand now.

I can therefore announce today that the financial assistance scheme will provide help to those within three years of their scheme pension age on 14 May 2004. The assistance will top up individuals to a level broadly equivalent to 80 per cent of the core pension rights accrued in their scheme. That means that those within three years of their pension scheme age on 14 May 2004 should expect to get 80 per cent of their core promised pension. As we previously announced, payments will be subject to a de minimis level and a cap on assistance provided. Further information on these will be provided when the draft regulations are published.

The assistance will be paid as a monthly pension. FAS payments will be treated by the tax and benefit system in broadly the same way as payments from an occupational pension scheme.

4.637. The statement concluded:

We have already committed ourselves to review the financial assistance scheme after three years. Government funding is already fixed for the current spending review period up to and including 2007-08. But as with all our spending plans, we will review the funding for the FAS in the next spending review alongside other spending priorities.

A dedicated team of DWP officials, based in York, will administer the scheme and aim to get payments to recipients as soon as possible once the regulations are in place.

4.638. In oral questions to DWP Ministers in the House of Commons on 28 February 2005, the FAS was discussed at length.

4.639. Alan Johnson, the then Secretary of State, said, as part of those discussions, that it was the intention of the Government to set the FAS cap at the same level as that for the PPF (but then corrected this statement to explain that the cap for the FAS would in fact be less, at £12,000 per annum); that it was intended to lay the FAS Regulations in the Spring, with approval of them by July 2005 and then to give a six month period in which individuals would apply for ‘assistance’; and that the sum set aside would be ‘on the basis
of our original calculations enough to give proper compensation’ to the affected people.

4.640. The spokesperson for the Official Opposition argued that the FAS was insufficient to remedy the losses incurred by those affected by insolvent scheme wind-ups, as £20 million a year would only provide approximately £1,300 per year to 15,000 people.


4.642. An additional announcement was made on 22 June 2005, as a result of the consultation exercise on the draft Regulations (see above). Revised Regulations were also tabled that day and it was announced that terminally ill members and those already over the age of 65 would receive advance, interim payments from the FAS. In addition, it was announced that those schemes where the sponsoring employer was not technically insolvent, but where it was also clear that it no longer existed, would be included within the scope of the FAS.

4.643. In the press notice that accompanied this announcement, the Pensions Minister, Stephen Timms, was quoted as saying:

We have always said that the aim of the Financial Assistance Scheme is to get money out as quickly as possible to those who need it most, and today’s regulations will put those words into action.

The ability to make early payments to qualifying members who are terminally ill and those reaching 65 before their scheme has completed winding up, will provide vital help to people suffering the worst difficulties.

4.644. At the same time, the Government published its response to the representations it had received in the consultation exercise on the draft FAS Regulations. In relation to the continued exclusion of members of solvent employer schemes, DWP said:

The Government believes that solvent employers have a duty to support their schemes and to provide the benefits that members were expecting. We recognise the difficulties which members of such affected schemes face. Nevertheless, we believe that it is right for FAS to focus its help on those schemes where there is no solvent employer at all.

4.645. In relation to opposition to the proposed ‘cut-off’ date, which meant that FAS ‘assistance’ would be available only to those within three years of their scheme’s normal retirement age at 14 May 2004, the Government said that it:

...acknowledges the strength of feeling that having such a ‘cut-off’ date arouses but believes that, given the funds available for the Financial Assistance Scheme, help must be focused on those who are facing the most urgent difficulties and are closest to, or have already arrived at, retirement age and therefore less able to replace their lost pensions. The FAS will be reviewed after three years and its funding will be considered in the next spending review alongside other spending priorities.

4.646. Finally, in relation to opposition to the proposal that ‘assistance’ would be available only from an individual’s 65th birthday, regardless of normal scheme retirement age, the Government said:

The FAS provides assistance to some of those who have lost out by the failure of their occupational pension scheme. It does not attempt to compensate for that loss or to reflect the rules and conditions of individual schemes: to do so would introduce administrative complexity and substantially increase costs. The Government considers that backdating FAS payments to the
later of the 65th birthday or 14th May 2004 means that taxpayers’ money made available for the scheme can assist the widest range of people.

The Government acknowledges that it would not necessarily be appropriate to delay FAS payments to eligible scheme members who reach their 65th birthday but whose schemes have not completed wind-up and for whom, therefore, a definitive award cannot be calculated. The Financial Assistance Scheme manager will, therefore, have the discretion to make initial payments at a ‘safe’ rate of 60% of expected pension entitlement to eligible scheme members who have attained the age of 65. This award will be recalculated and any arrears paid when their scheme completes wind-up. The Government believes that this approach ensures that members are not grossly penalised for delays in the winding-up process and reflects the approach of many pension schemes in making similar ‘safe’ payments to members in similar circumstances.

The Government has also decided that in cases where a scheme member aged under 65 is eligible for the FAS, suffering from a terminal illness and not expected to live for longer than six months, then FAS payments will be made with immediate effect.

4.647. On 1 September 2005, DWP announced that scheme trustees who had not yet submitted information to the FAS had six months to apply for registration. It also published guides to the FAS – one for scheme members and another for trustees, their advisers and other pensions professionals.

Other developments during 2005

4.648. In the meantime, on 10 January 2005, the then Pensions Minister, Malcolm Wicks, had urged employees to consider seriously their pensions options. According to the DWP press release:

...one of the easiest ways to do this is to check what options your employer can offer you. There are approximately 4.5 million people who have access to company pension schemes but have not joined them. Where an employer makes a contribution to the scheme, these individuals are missing out on a significant employee benefit.

4.649. On 24 February 2005, DWP published a document, entitled ‘principles for reform – the national pensions debate’, that set out the principles that the Government had decided would guide pension reform. The principles set out were that:

(i) the pensions system must tackle poverty effectively;
(ii) the opportunity to build an adequate retirement income should be open to all;
(iii) affordability and economic stability must be maintained;
(iv) the pensions system should produce fair outcomes for women and carers;
(v) reform should seek to establish a system that people should understand; and
(vi) reform should be based around as broad a consensus as possible.

4.650. On 11 March 2005, DWP issued a consultation document that set out the Government’s proposals to allow contracted-out benefits to be paid as part of a cash lump sum.

4.651. On 22 March 2005, DWP issued a further consultation document that set out its detailed proposals related to the new scheme funding requirements which would include a new statement of funding principles and the requirement for trustees to keep members informed about the funding of their schemes.

4.652. On 5 April 2005 – almost eight years to the day since the commencement of the relevant
provisions of the 1995 Act – many of the relevant provisions of the Pensions Act 2004 came into force, including the establishment of the new regulatory body to replace OPRA and the beginning of the operation of the PPF.

4.653. On 14 June 2005, DWP published its research report, entitled ‘effective means of conveying messages about pensions and saving for retirement’. While this research had largely focused on money purchase schemes, in relation to tackling a lack of understanding and awareness of pension choices relating to final salary schemes the report concluded that, for those respondents who had trust in Government or banks, they would seek information from them about their pension options. Those who had no such trust would rely on information from family members or friends.

4.654. On 20 July 2005, a Memorandum of Understanding between DWP, the PPF and the Pensions Regulator was agreed and published.

4.655. On 1 September 2005, DWP announced that the new funding framework for defined benefit pension schemes would come into force on 31 October 2005.

**NAO report on DWP leaflets**

4.656. On 25 January 2006, the National Audit Office published a report by the Comptroller and Auditor General entitled ‘Department for Work and Pensions: using leaflets to communicate with the public about services and entitlements’.

4.657. The report examined ‘how effectively the Department manages the risk of providing inaccurate information in its leaflets’ and also considered ‘whether the Department communicates clearly and effectively’ in its public information leaflets.

4.658. The NAO recognised that ‘it is vital that customers can rely on the accuracy of this information to make informed choices about their lives’. It also recognised that ‘the need to convey often complex information in accessible formats is a constant challenge for the Department, on the one hand ensuring that information is complete and accurate, but on the other, that often complex information is concise and accessible’.

4.659. The report said that the impact of inaccurate and incomplete information in DWP leaflets would impact on its efficiency and might lead to ‘inappropriate decisions by customers’, to ‘inappropriate claims by customers’, and to ‘social exclusion and confusion’.

4.660. In noting that ‘a key objective of the Department for Work and Pensions is to ensure that accurate and timely information is provided to its customers and the wider public’, the NAO said that DWP:

... identifies and records its risks via a strategic risk register, which is reviewed routinely... This register lists “providing unreliable advice or information to the public” as one of its 17 key corporate risks.

4.661. In a section of the report dealing with managing the risks of not communicating clearly, the NAO said that:

Citizens should be able to rely on the accuracy and completeness of information provided by all government departments. Citizens use the information government departments supply to judge the performance of schools and hospitals, make benefit claims, make arrangements to travel abroad, complete tax forms and much more. Written communication (in particular leaflets, letters and paid-for advertising) is regarded by the public as the most trustworthy source of information from Government.

4.662. One of the report’s recommendations was that DWP should ‘ensure all its agencies treat
inaccurate and incomplete information as a key risk’. The NAO said that DWP:

... must better identify the risks associated with communicating with the public and ensure all its agencies include the issue on their risk registers and monitor actions to manage the risks regularly.
5. Findings

Introduction
5.1. This chapter sets out my assessment of the evidence that my investigation has disclosed and my determination of whether the actions and/or omissions of the bodies complained about constitute maladministration causing injustice to individuals.

5.2. I will begin by outlining the key conclusions I have drawn about the role of the bodies complained about from the evidence I have investigated.

5.3. I will then set out the questions that I have asked. Finally, I will set out my findings on these matters.

The role of public bodies – conclusions from the evidence
5.4. I consider that the evidence about the matters that I have investigated demonstrates the following about the role of Government in occupational pension provision during the period relevant to my investigation.

5.5. First, the public bodies under investigation had responsibilities in relation to the aspects of final salary occupational pension provision that are the subject of this investigation.

5.6. In particular, DWP and its predecessor were responsible for the legal framework governing such provision and took the lead within Government on policy issues related to it. In addition, OPRA was the regulator of such provision and NICO participated (with OPRA) in the process of winding-up final salary schemes where that occurred. This is apparent from the nature of the legal, regulatory and administrative frameworks described in annex A to this report.

5.7. Secondly, the Government saw itself as acting – and told the public that it was doing so – in partnership with others both to promote the benefits of membership of occupational pension schemes and to remind individuals that, where they could, they had an obligation to save for their retirement.

5.8. The Government’s role in the promotion of membership of pension schemes is apparent from official statements throughout the period relevant to this investigation – ranging from the Ministerial press notice to accompany the publication in June 1998 of the report of the Pensions Education Working Group to DWP’s evidence to the Work and Pensions Select Committee in October 2002. It is also apparent from other official statements, including in the December 1998 Pensions Green Paper and answers given to parliamentary questions in November 2001.

5.9. The Government’s view that saving is an obligation on those who can afford to do so is also apparent from the 1998 Green Paper and from various Ministerial statements in Parliament such as those in February 1999 and November 2001.

5.10. Thirdly, the Government recognised throughout the relevant period that pensions were complex and often not a topic that was generally understood and that, consequently, there was a need for greater financial education, for improved awareness of pensions, and for clearer information about the various savings options.

5.11. This is apparent from the public observations of OPRA both in June 1997, shortly after the Pensions Act 1995 came into force, and in April 1999. It is also apparent from the work of the Government-appointed Pensions Education Working Group – published in June 1998 – from the official response to that work, and from the whole thrust of the Pensions Green Paper published in December 1998.

5.12. Fourthly, the Government saw itself as having a key role in promoting such better
education, awareness and information about pensions and saving for retirement – and told others that it would do so.

5.13. This role was discussed in, among other places, the Pensions Green Paper of December 1998, in a Cabinet Office report in April 2000, in the joint DWP-Treasury consultation on the MFR issued in September 2000, in DWP evidence given to a parliamentary Select Committee in October 2002, and, most recently, in DWP’s later publications on ‘informed choice’.

5.14. **Fifthly, the Government said at the relevant time that the information leaflets and other official publications issued by public bodies were an integral component of the promotion of the benefits of saving for retirement and aimed to assist people to make informed choices about various pensions options.**

5.15. OPRA publicly accepted in June 1997 that part of its role was to ‘[get] across important messages to all those involved in workplace pension schemes, including scheme members’ and described its relevant publications as aimed at giving ‘trustees a better understanding’ of the issues related to running a pension scheme.

5.16. In addition, the then Pensions Minister told the TUC in June 1998 that DWP leaflets were ‘user-friendly’ and would ‘reinforce the message’ of the importance of saving for retirement. Moreover, in the December 1998 Green Paper the Government said that its then current proposals included the provision of ‘better information’ both on the various pensions options and on the general need to save. That Paper also described official publicity leaflets as being their ‘steps to ensure that people are better informed about pensions issues generally and about the options available to them as individuals in particular’.

5.17. While Government did on occasion state that their information products were not sufficient in themselves to enable individuals to make complex financial decisions, the December 2002 Pensions Green Paper did suggest that official material from that period on would [move] *the emphasis... away from promoting simple awareness of the need to save and towards information that will prompt people to take action*. Furthermore, in earlier evidence to a Select Committee in October 2002, DWP had suggested that the ‘role of the state’ was ‘to provide clear and accurate information about what pensions will provide so that people will understand how much they can expect at retirement before it is too late to do something about it’.

5.18. **Finally, the Government accepted at the relevant time that it had certain obligations in relation to the accuracy, completeness, clarity and consistency of its publications.**

5.19. There is no general statutory or common law obligation on public bodies to provide information or advice to members of the public. However, it was recognised by legal advice provided to DWP in May 2000 that, where DWP or another public body chooses to provide information, this should be correct and complete. Such advice constituted, along with other things such as its public statements, the ‘internal’ standards to which DWP should have had regard.

5.20. In addition, as noted in chapter 2 of this report, previous Ombudsmen have held that a public body may be deemed to have acted with maladministration either where it had knowingly provided information or advice which was misleading or inadequate or where it had failed to follow its own procedures or policies in relation to the provision of such information or advice. I concur with that view.
5.21. Leaving aside for now considerations of the law and of good administration, in such situations where information is provided – and in the context relevant to this investigation – DWP’s own internal guidance set additional standards against which its publications and other official statements might be judged.

5.22. Following the ‘Accuracy of Information Project’ – itself a consequence of reports by my predecessor and by the Comptroller and Auditor General which found that the quality of information provided by DSS about changes to the inheritance of SERPS had been seriously deficient – from March 2002 DWP’s ‘Public Information Policy Statement’ had set out such guidance.

5.23. The Statement provided, first, that, in order to meet ‘communication requirements’, all information provided by DWP should be ‘appropriate, relevant, correct, up-to-date, clear, concise and to the point, helpful and targeted’.

5.24. Secondly, and notwithstanding the lack of a general legal duty to provide information, it stated that:

*It is widely accepted that the Department has a duty to give information or advice [to] inform the public about any new policies and developments that may affect them and, crucially, keep them informed on a continuing basis of their rights and responsibilities. It would be unreasonable for the Department not to do this and it is clearly a necessary part of our business.*

5.25. It continued:

*The Department must take care to achieve the necessary balance of resource and effort between announcing changes and new policies and our duty to provide routine information. The common law duty of care means that any information we provide must be timely, complete and correct.*

*The Department may also be held responsible if we give advice and someone relies on our advice to their detriment.*

5.26. In addition, this general strategy was, for information provided by the Pensions Service, complemented by a ‘Standards Framework’, aimed at front-line staff. This framework provided that *the Pensions Service has a responsibility to provide factual, accurate, timely and appropriate information to all of its customers through all appropriate media*.

5.27. In relation to the general advice provided by the Pensions Service, the framework said that it would encourage individuals to plan for a secure retirement and, where possible, to save to achieve this.

5.28. Finally, the quality assurance process established by the framework said that individual information and advice provided by the Pensions Service in correspondence, telephone calls or in face-to-face interviews would be reviewed by assessing, among other things, whether:

- the information and advice given was *accurate and up-to-date*;
- it was *comprehensive*;
- it was *tailored to the customer’s circumstances*; and
- it mentioned *appropriate future legislative changes*.

**My approach to determining the complaints**

5.29. Having set out key conclusions from the evidence that I have scrutinised as part of this investigation, I now turn to the determination of whether maladministration occurred and, if so, whether it caused – or contributed to – the injustice claimed by those who have complained to me and others in a similar position to those complainants.
5.30. Before doing so, I should explain that the findings I come to below were determined following consideration of submissions made by DWP during the investigation in relation to my initial concerns about certain issues. Those submissions, and my assessment of them, are set out in annex C to this report.

5.31. The rest of this chapter sets out my findings – that is, my answers to the following questions:

(i) did maladministration occur?

(ii) if so, did individuals suffer injustice?

(iii) if such injustice exists, has it been remedied?; and

(iv) did any maladministration I have identified cause – or contribute to – any unremedied injustice?

Did maladministration occur?

5.32. As explained in chapter 2 of this report, my approach to the determination of whether maladministration has occurred is broadly structured around consideration of the following aspects of the complaints I have received:

(i) first, whether the information provided by the bodies under investigation was clear, complete, consistent and accurate;

(ii) secondly, whether the bodies under investigation took the disputed decisions about the MFR and the disclosure of risk without maladministration; and

(iii) thirdly, whether the bodies under investigation undertook their responsibilities in relation to the process of winding-up certain contracted-out final salary schemes without undue delay or other administrative error.

5.33. In dealing with the first aspect, I will consider the following information provided by DWP (and its predecessor) and OPRA in relation to the security provided to the accrued pension rights of scheme members by the MFR:

(i) what public bodies said about the intention of the MFR before it was devised and implemented;

(ii) what public bodies said about the security provided by being funded to the MFR level when it was announced and introduced; and

(iii) what public bodies said about such security during the operation of the regime of which the MFR was a component part.

5.34. In relation to the second aspect, I will consider three discretionary or policy decisions taken by public bodies in relation to the MFR and risk:

(i) the decision to change the MFR basis in June 1998 by amending the equity market value adjustment;

(ii) the decision, communicated in March 2001, not to make new disclosure to scheme members (as it was claimed had been recommended by the actuarial profession) of the risks to their pensions and to explain the degree of security afforded by being funded to the MFR level; and

(iii) the decision in March 2002 to change the MFR basis by making a further change to the equity market value adjustment.

5.35. Finally, in relation to the third aspect, I will consider whether the actions of NICO in relation to the schemes with which the four representative complainants were associated – and their handling of the wind-up of the other sample schemes I have examined – constituted maladministration.

Findings – official information

5.36. I turn first to whether the information provided by DWP and OPRA about the security
of the pensions of members of final salary schemes was clear, complete, consistent and accurate.

5.37. In relation to the period prior to the introduction of the MFR, the two principal sources about the intention behind the 1995 legislation which introduced it – and about the specific purpose of the MFR – were the statements made by Ministers during the passage of that legislation and in the official leaflet published by DSS in January 1996 to explain what Parliament had enacted.

5.38. Having regard to the relevant debates set out in chapter 4 of this report, I consider that anyone reading or hearing the Ministerial statements about the MFR and the purpose behind this statutory mechanism would have reasonably believed that a scheme funded to the MFR level would have enough assets to pay the pensions already in payment and to provide a cash transfer value of the accrued pension rights of non-pensioners, regardless of what happened to the employer. On many occasions, Ministers emphasised that this was the case during passage of the legislation that introduced the MFR.

5.39. Leaving parliamentary statements aside to turn to the official information which is the focus of this investigation, the leaflet published by DSS in January 1996 stated that the aim of the Government in introducing the Pensions Act 1995, of whose provisions the MFR had been a key component part, was ‘to remove any worries that people had about the safety of their occupational... pension following the Maxwell affair’.

5.40. Despite the warnings of the actuarial profession in 1994 and 1995 that there was a danger that scheme members would be misled as to the degree of security that the MFR would provide and the Government’s recognition at the time that ‘it is important’ how what became the MFR ‘is explained to members’, the leaflet went on to say that the MFR ‘aimed at making sure that... schemes have enough money in them to meet the pension rights of their members’ and that ‘pensions are protected whatever happens to the employer’.

5.41. The leaflet also assured the reader that, on wind-up, a scheme funded to the MFR level would ‘provide all younger members with a cash value of their pension rights’. No mention was made that the Government intended for non-pensioners that they would only have a ‘reasonable expectation’ that this would be the case, still less that such an expectation meant only an ‘even chance’.

5.42. DSS had been given warnings that care had to be taken to ensure that scheme members did not misunderstand the degree of protection that the new legislative framework would provide for their pension rights. They had a responsibility to ensure that there were no significant omissions from any information they chose to publish.

5.43. Given this, I consider that the failure to ensure that the most fundamental aspect of the MFR – the policy intention that Government would adopt towards what the MFR would actually provide in terms of security for scheme members – was included in the official information given to people to ‘remove any worries’ they might have was highly unsatisfactory. It misled the readers of that leaflet by giving them assurances that were never intended to be met.

5.44. Turning now to the publicity surrounding the introduction of the MFR, this continued to give a misleading impression – by saying (my emphasis) that ‘schemes funded to this minimum level will be able, in the event of an employer going out of business, to continue paying existing pensions and provide younger members with a fair value of their accrued rights which they can
transfer to another scheme or to a personal pension’.

5.45. Furthermore, during the operation of the MFR, official statements about the security provided by a scheme being funded to the MFR level continued to be vague, incomplete or misleading.

5.46. It was not the case that the concept behind the MFR was that ‘people who have built up pension rights should be able to draw their pensions in full, even if the employer is no longer there to pay extra contributions’ as was stated in the December 1998 Green Paper.

5.47. No mention of risk or of the real intention behind the MFR was made in any of the general information leaflets produced by DWP and it was not until the April 2004 edition of ‘Occupational Pensions: Your Guide’ that any mention of scheme wind-up as a relevant factor in relation to pension security was made.

5.48. I do not accept DWP’s submission that it would not have been appropriate to cover risk in its publications. I note that OPRA, the regulatory body, had told DSS in January 2001 that ‘risks need to be explained clearly to members’. The December 1998 Green Paper had also said that official information to be provided by DWP and others to support the need that existed for ‘clear information and advice’ and which would help to ‘improve the general quality and comparability of pensions information’ would (my emphasis) ‘include promoting awareness of the benefits and the risks associated with different kinds of investment and providing appropriate information and advice’.

5.49. Given this – and other similar examples – I consider that DWP’s current submissions about what I should now expect from official information are incompatible with what DWP and other public bodies at the time said about the information they would provide – and to the role that they then saw themselves playing in relation to financial education.

5.50. In addition, I note that the first time that public statements were made – albeit not in the leaflets aimed at the public – that the MFR provided for non-pensioners only ‘a reasonable expectation’ – defined as an even chance – of providing a transfer value that would, following investment, give them their full pension was on publication of the consultation on the MFR in September 2000. This was more than three years after the MFR became operational and almost five years since the enactment of the relevant legislation. Official leaflets aimed at the public never made this clear.

5.51. Whether it is ‘reasonable’ that such an expectation might denote only a 50% chance is not clear to me, although I do not consider that this would be a usual interpretation of such an expression.

5.52. Leaving this aside, I have seen that this intention had been referred to prior to September 2000 in internal DWP documents and in setting the terms of reference for the actuarial profession’s review of the MFR, which were only made public at the same time as the publication of the above consultation.

5.53. Indeed, as is shown in chapter 4 of this report, the Government had instructed the actuarial profession on 22 November 1995 that they should devise an actuarial basis for the MFR that would only deliver ‘at least an even chance’ that non-pensioner members would receive a cash value that, when invested elsewhere, would replicate the pension that they would have received had their scheme not wound-up.

5.54. However, this intention was significantly different from what was said publicly by Government about what the MFR was intended
to achieve. I remain extremely concerned that no statement to the public had been made prior to September 2000 that this was the intention of the MFR – and that the implications of this were only clearly stated in April 2004.

5.55. Furthermore, DWP and its predecessor knew that scheme members had no idea of the risks to their pensions but their leaflets and other public statements did nothing to dispel that lack of awareness – indeed, they reinforced it.

5.56. Do all of these failings constitute maladministration? Public bodies chose to publish information to support Government’s general policies of making people aware of their pension options and of encouraging membership of occupational pension schemes.

5.57. Whether or not it had a general duty to provide information about these policies and about the legal framework that it had established and was responsible for overseeing, DWP provided such information.

5.58. According to legal advice it received, information DWP provided had to be ‘clear and reliable’ and its officials at the time had recognised that its role should be to ‘give accurate information’ on pensions options. ‘Telling only part of the story’ was also recognised at the time as being equivalent to providing incorrect information.

5.59. In this context, I consider that the early official publications issued by DWP and its predecessor did not meet the standards they set for themselves.

5.60. Furthermore, from 22 March 2002, DWP’s own formal internal guidance required that the information it provided was, among other things, appropriate, relevant, correct and clear. It had also earlier agreed, on 11 September 2001, that accurate information would contain ‘no significant omissions’.

5.61. The May 2002 edition of ‘Occupational Pensions: Your Guide’, which was issued after the agreement of DWP’s Public Information Policy Statement, contained 28 pages of text. Yet it made no mention of the risks to accrued pension rights should a scheme be wound up with insufficient funds to meet all of its liabilities; nor did it mention the statutory priority orders which would have an impact on the amount of money a non-pensioner might receive in such a situation.

5.62. The position with the April 2003 revised leaflet was similar. Neither explained the policy intention behind – or the necessary effects on pension security of – the MFR. Both editions did, however, contain approximately 250 words about how an individual might make additional contributions to a final salary scheme and also more than 300 words about pension sharing on divorce.

5.63. Even following the first public statement – in what amounted to a footnote to the September 2000 consultation document – that non-pensioners had only an ‘even chance’ of replicating their pensions, conflicting messages were being given about the security afforded by the MFR to pension rights within final salary schemes.

5.64. In a parliamentary debate on 3 July 2001, the then Minister continued to say that the MFR was intended where a scheme wound up due to the insolvency of the sponsoring employer ‘to provide younger members with a fair value of their accrued rights’.

5.65. I note – but do not accept – DWP’s explanation (set out fully in annex C to this report) of what ‘fair value’ means.

5.66. Such an explanation is not consistent with the other, less qualified statements in Parliament and in official information about
what a non-pensioner scheme member would be
entitled to on wind-up. Furthermore, I am not
persuaded that any reasonable person
considering the phrase ‘fair value’ would take it
to mean without further explanation what DWP
now tells me that it always meant – that is, a
value that would provide only a 50% chance of
receiving the expected pension following the
investment of a transfer value of accrued rights.

5.67. I have seen nothing that would make me
doubt that the Government’s intention behind
the MFR was always that it could only provide a
limited degree of security to non-pensioner
members – which was apparent from its design –
and I have seen that the discussions behind
closed doors within and between the public
bodies responsible for occupational pensions
policy generally reflected this.

5.68. However, this was not properly disclosed to
those most affected by such an intention.
I consider that the official information given to
the public about the degree of security provided
by a scheme being funded to the MFR level:

(i) was, prior to September 2000, misleading,
incomplete and inaccurate – in that it gave
assurances which were incompatible with
the design and purpose of the MFR as
prescribed by Government – and with its
practical operation.

These assurances were that the MFR was
designed to ensure that schemes had
sufficient assets to meet their liabilities and
that a scheme funded to the MFR level
would be able to pay cash transfers of
accrued rights to non-pensioners. In
addition, no disclosure or even mention was
made of risks to accrued rights or of the
potential effects of statutory priority orders
on wind-up;

(ii) was, between September 2000 and April
2004, deficient – in that it lacked any
degree of consistency as to what might be
expected from the MFR.

Some official statements and publications –
especially those aimed at the general public
– continued not to mention risk and to give
a misleading impression as to the security of
pension rights, while others began to explain
the true position; and

(iii) was only broadly accurate from April 2004
onwards.

5.69. I consider that these findings are reinforced
if DWP publications are read in conjunction with
other official publications.

5.70. For example, OPRA’s publications, which are
within the scope of this report, were inconsistent
and therefore deficient. Earlier publications
contained some potentially misleading
statements that eventually were balanced by
others that set out the real position more
appropriately.

5.71. Complainants have told me that official
assurances about the security of their pensions
gave them what turned out to be a false sense
of security. I can understand why they felt this.
In my view, official information about these
matters was not clear, complete, consistent or
always accurate.

5.72. DWP’s own standards provided – and the
advice it received at the time suggested – that
information it produced had to be complete and
accurate. I consider that the deficiencies in
official information that I have identified above
meant that this information did not conform to
the standards set for itself by DWP – whether in
relation to what it recognised and was advised
was appropriate at the time, or to its public
information strategy, or to its wider and self-
acknowledged role within financial education.
5.73. Moreover, I would expect official information about such important matters to be clear, complete, consistent and accurate – especially where Government had at the time recognised that there was considerable scope for misunderstanding and also a need for clearer information. I consider that official information provided in this case fell far short of what was appropriate in this context and therefore it did not accord with principles of good administration.

5.74. For both of these reasons, I consider that the deficiencies in the relevant official information that I have identified constituted maladministration.

Findings – discretionary decisions taken by DWP

5.75. I now turn to consider the three discretionary decisions taken by DWP which have been complained about: two in relation to changes to the MFR basis and one not to proactively disclose to pension scheme members the fact that their pensions might be at risk – the latter allegedly in spite of a recommendation to do so by the actuarial profession.

5.76. In doing so, it is important to reiterate what I have said in chapter 1 of this report, namely that the law provides that I may not question the merits of discretionary decisions taken without maladministration.

The 1998 reform of the MFR

5.77. In relation to the first decision in March 1998 to alter the equity market value adjustment (MVA) assumption that formed part of the MFR basis, I have seen no evidence that that decision was taken with maladministration.

5.78. Not only was the decision taken after DWP had regard to the available options, it was taken after full consideration of the advice of the actuarial profession – which was supported by further evidence and statistics to back that advice up.

5.79. In addition, it was decided to give no publicity to this reform in addition to that given by the actuarial profession to inform their members. While not everyone would have taken this view when dealing with a decision that affected the pension security of so many people, the decision not to give publicity to the change to the MFR basis was a decision that DWP was entitled to take, and was not wholly unreasonable in all the circumstances.

5.80. Furthermore, in the absence of any official publicity about this decision, it would be difficult to establish that someone could have been misled about it.

5.81. I therefore cannot uphold complaints about this decision, as it was not taken with maladministration.

The 2001 decision not to disclose risk

5.82. I now turn to the decision not to disclose the risks to scheme members in the light of the actuarial profession’s recommendation that such disclosure should be made because scheme members did not understand the role and purpose of – and the degree of security provided by – the MFR.

5.83. It should be noted first that the recommendation by the actuarial profession was not that the Government should communicate directly with scheme members but rather that disclosure – perhaps through scheme administrators and trustees – should be effected by pensions professionals or by others in partnership with them, which may have included – or been facilitated by – public bodies.

5.84. In any case, as is clear from chapter 4 of this report, DWP consulted on the various options for disclosure and it established a consultative panel to help it decide, with key stakeholders,
what should be done in the light of the whole of the actuarial profession's recommendations.

5.85. I have scrutinised all of the papers provided to me relating to the work of the panel. It is apparent that there was no consensus on what should be disclosed, in what manner and by whom. The issue of disclosure was recognised as an important one and it was taken up as part of the work done to effect a more fundamental reform of the statutory framework, including the abolition and replacement of the MFR.

5.86. Not everyone would have taken the same decision faced with information that scheme members were under an illusion that the MFR provided them with more security than it did. However, the decision by DWP – not to undertake new and direct communication with scheme members to inform them of the risks – was one that DWP was entitled to take.

5.87. Nevertheless, it should be remembered that decisions as to how DWP should respond to the actuarial profession's recommendations were taken in a context where the Government had recognised that it had a key role to play in informing citizens about their pension options and where the Government was encouraging individuals to join their occupational scheme where possible through its publications and other official information.

5.88. It should also be remembered that the actuarial profession had been concerned that scheme members might be misled as to the security of their pensions since before the MFR had been introduced – and had communicated those concerns to DWP's predecessor and made recommendations about the need for an awareness campaign to dispel any misunderstandings.

5.89. It seems to me that the issue of new disclosure in the light of the actuarial profession's recommendation could not be divorced from consideration of what had given scheme members the false assurance that their pensions were safe.

5.90. That being so, I am concerned that – faced with further evidence that scheme members were wholly unaware of the risks to their pensions and that they did not understand the degree of security that the MFR provided – DWP did not separately review the information about the security of final salary pensions that it had already placed – and was continuing to place – in the public domain.

5.91. I consider that, within the discretion afforded to it by the law, it was open to DWP not to make new disclosure about such issues.

5.92. However, at the same time, it seems to me that it was incumbent on DWP, given what it knew, to ensure that the information that it had already produced and was continuing to publish did not add to the misunderstandings that it knew and recognised existed about the MFR and the security of final salary pensions.

5.93. This was a relevant consideration but I have seen no evidence that DWP considered it. I have therefore concluded that the failure by DWP at that time to review the official information it provided constituted maladministration.

5.94. This was a lost opportunity for Government to take action to remedy the huge discrepancy between what it had told the public was the purpose of the MFR and the policy intention that Government had been working with behind closed doors since the inception of the MFR.

The 2002 reform of the MFR

5.95. I now turn to the second decision, taken in March 2002, to change again the equity MVA element of the MFR basis.
5.96. In its initial response to the complaints I have investigated, DWP said that this change, like others, had been made following recommendations to do so by the actuarial profession – and had had the intention of realigning the MFR with its original level, from which it had departed due to economic and demographic trends. DWP also said that these changes were not at the relevant time seen to constitute a weakening of the MFR or of the protection afforded by it to scheme members. This position was reaffirmed by DWP in subsequent submissions.

5.97. As I understand matters, the actuarial profession, working to instructions given to them by DWP and its predecessor, made four sets of recommendations concerning the actuarial basis of the MFR.

5.98. The first set of recommendations was made in May 1998, although the precise recommendations made then were a revised version of earlier recommendations made in December 1997 in the light of the 1997 Budget. The profession argued that the MFR was then stronger than originally intended and proposed changes to its basis to weaken the MFR in order to bring it back to that original intention. The Government approved this set of recommendations and implemented the change to the MFR basis in June 1998.

5.99. The second set of recommendations was made in May 2000, although the profession had first intimated that it would make these recommendations in November 1999. The profession argued that the MFR was then weaker than had been originally intended and proposed changes to its basis to strengthen the MFR in order to bring it back to that original intention. The Government decided not to implement those recommendations. In ‘Security for occupational pensions: the Government’s proposals’, its March 2001 response to the MFR consultation, the Government said that:

The consultation document also included proposals for some limited changes to the MFR, recommended by the Faculty and Institute of Actuaries. Most of those who responded to the consultation document did not support the package of interim changes to the MFR and many commented that they should not be made if the MFR was to be replaced in the near future. The Government is proposing to replace the MFR and feels that it is not therefore sensible to introduce these changes now.

5.100. The third set of recommendations was made in September 2001. The profession argued that the MFR was then stronger than originally intended and proposed changes to its basis to weaken the MFR in order to bring it back to that original intention. The Government approved this set of recommendations and implemented the change to the MFR basis in March 2002. This decision is, with that made in June 1998, one of those that have been complained about.

5.101. A fourth recommendation was made in February 2003. The profession argued that, since the last change to the MFR basis in March 2002, the MFR ‘had weakened substantially’ to the extent that it was weaker than had originally been intended. The profession said that changes were necessary to strengthen the MFR and that, if those were not made, ‘retaining the MFR at its current strength’ prior to replacement of the MFR ‘would represent materially less security of members’ benefits, especially where schemes are funded at the MFR minimum level’ compared with the security ‘implicit in the MFR when it was originally introduced’. The Government decided not to amend the MFR basis as the MFR was due to be abolished.

5.102. It seems to me that a number of conclusions can be drawn from the above. The first is that it is
clear that the actuarial profession, in line with its instructions, monitored the MFR basis against the policy intention set for the MFR by Government – and that the profession made a number of recommendations over time, which were aimed at ensuring that the MFR remained aligned with the level intended by Government.

5.103. The second conclusion I draw is that, of the four sets of recommendations made by the profession concerning the MFR basis, only two were implemented by the Government.

5.104. It is clearly not the case that the existence of a recommendation from the actuarial profession – couched in terms of ensuring MFR alignment with the Government’s policy intention – was sufficient cause for DWP to agree to change the MFR basis.

5.105. Indeed, while it may be nothing more than coincidence, the Government chose over this period to implement two sets of recommendations that would relieve the burdens on sponsoring employers while rejecting two sets of recommendations that would increase the degree of protection afforded to scheme members.

5.106. It is also clearly not the case that the decision-making approach taken by DWP was consistent in relation to each recommendation from the actuarial profession.

5.107. Decisions in relation to three of the profession’s recommendations – those decisions taken in relation to the sets of recommendations made in May 2000, September 2001, and February 2003 – were all taken after the decision by Government to replace the MFR. That replacement was part (or all) of the reasoning given for rejecting both of the recommendations that would have strengthened the MFR.

5.108. And yet the decision made in March 2002 to implement the profession’s recommendation to weaken the MFR basis was also taken after it had been decided that the MFR would be replaced.

5.109. Having carefully considered the above, I am not satisfied that the 2002 decision to change the MFR basis can be said to have been taken properly simply because it rested on a recommendation from the actuarial profession that was designed to maintain a policy intention. Nor am I satisfied that DWP’s decision was in line with consistent practice in relation to the other recommendations made by the actuarial profession.

5.110. No statement of reasons was set out in the submission to Ministers seeking approval of the 2002 change to the MFR basis as to why this particular recommendation was more worthy of implementation than the 2000 recommendations which came from the same source and which had the same aim – and which was taken in the same context of impending replacement of the MFR.

5.111. I note also that the later decision in 2003 not to amend the MFR basis to strengthen it also relied on the impending abolition of the MFR, despite recognition that the MFR was considerably weaker then than had been intended, provided, for example, in a Ministerial answer given in July 2003 – which said that, by June 2003, 50% of pension schemes were funded below the MFR level but that, if no changes had been made to the MFR basis since May 1997, 75% of schemes would have failed the MFR ‘test’. Clearly, the MFR by June 2003 was a considerably weaker test than it had at first been – or than it had been originally intended that it should be.

5.112. If the March 2002 decision to change the MFR basis was not one that was taken within a consistent framework of implementing the recommendations of the actuarial profession to ensure alignment of the MFR with its original policy intention, on what basis was this decision taken?
5.113. The effects that the economic and demographic context was having on the strength of the MFR test were a prime factor in the decision-making context. As I have said in chapter 3 of this report, my focus on considering this decision is on assessing whether it was taken with regard to a properly documented evidence base and that it was taken with a full assessment of relevant considerations but without regard to irrelevant considerations. To do this, it is not necessary to come to a view as to whether the advice on that context, provided to DWP in September 2001 by the actuarial profession, was soundly based – or as to whether the assessment of it by my advisers, which I accept was undertaken some years later, is an accurate critique, although, as I have said, I am satisfied that the advice I have received is robust.

5.114. When investigating complaints about discretionary decisions, I will first consider the manner in which a particular decision was taken and the evidence base on which that decision was taken. Clearly, when doing so, I must have regard to the reasons given for the decision at the time.

5.115. Before turning to consider the explanation provided by DWP for its decision, it seems to me that the following can be established from the evidence I have seen:

(i) that, by May 2000, the MFR was weaker than had originally been intended as a result of a number of factors and trends, including external economic conditions and the abolition of scheme tax credits (according to, for example, the actuarial profession’s briefing submitted in November 1999, and Ministerial briefing provided by officials in October 1998, November 1999 and May 2000);

(ii) that it was known at the time that the type of change to the equity MVA that was proposed both in May 2000 and in September 2001 – if implemented alone – would have the effect of weakening the MFR (according to, for example, the September 2000 DWP regulatory impact assessment of the 2000 proposals and also the actuarial profession’s letter to DSS in September 2001); and

(iii) that the actual effects of the March 2002 change were to weaken the MFR test (according to, for example, the answer to a parliamentary question given on 14 July 2003, which bears out the significance and direction of this change).

5.116. In that context, how did DWP go about taking its decision? DWP had said at the time that it would undertake a ‘considered and balanced’ assessment of the actuarial profession’s September 2001 recommendation as part of a ‘full consideration’ of reform of the MFR.

5.117. In order to establish whether the March 2002 decision by DWP to approve the change to the MFR was taken without maladministration, I evaluated the degree to which DWP undertook such an assessment prior to making its decision to amend the MFR basis.

5.118. DWP has told me that they approved the 2002 change having been guided by the clear recommendations from the actuarial profession as a whole, supplemented by advice from the Government Actuary’s Department’. As I have said above, such recommendations and such advice alone do not explain the reasons why DWP agreed to make this particular change to the MFR basis.

5.119. Yet, even if I were persuaded by such an explanation, which I am not, I have a number of concerns about the way in which DWP tell me that they took this decision. These concerns relate to whether DWP undertook the ‘full
consideration’ of the evidence that it had said that it would undertake.

5.120. First, it appears that DWP did not ask the actuarial profession for evidence to support their brief assessment of the changed economic and demographic context that would help explain why the profession argued that that context in September 2001 was having the opposite effect on the strength of the MFR from what it had said was the case less than eighteen months previously.

5.121. Secondly, I have seen only one email, sent on 25 September 2001, from GAD to DWP in which these issues were discussed and in which GAD’s advice was given. The advice on this particular proposal was given less than three weeks after the actuarial profession’s recommendation had been made and amounted to two sentences.

5.122. Whether the economic context had changed in the way suggested by the actuarial profession in the period from May 2000 to September 2001 is not clear from the evidence I have seen, although whether such was the case should have been critical to any determination by DWP of whether a decision to change the MFR was reasonable in all the circumstances.

5.123. My advisers have expressed doubts that the advice provided by the profession was accurate in all the then relevant circumstances. Nevertheless, I accept that it was the view of the actuarial profession in September 2001 that changes to the economic context between May 2000 and September 2001 had had the effect of so significantly changing the strength of the MFR that it had in that period gone from affording considerably less protection than had been intended to being stronger than the policy intention had provided for. I also accept that this view was communicated to DWP.

5.124. As with any decision, I should say that I do not consider that advice or a recommendation from the actuarial profession – or from GAD or any other professional adviser – absolved DWP from seeking to establish all of the relevant facts before making their decision.

5.125. A decision-maker, although acting with the benefit of professional advice, retains responsibility for their decision. Regard should be had to all relevant considerations and those which are not relevant should be ignored. It should also be ensured that any decision taken is made on an adequate evidence base and that the reasons for any decision can be demonstrated subsequently.

5.126. Having examined the evidence before me, I am not persuaded that DWP’s decision was taken after proper consideration of all the evidence that could have been available to it.

5.127. It seems to me, first, that the advice provided by the actuarial profession was insufficient in itself to enable DWP to come to a ‘considered and balanced’ assessment as to whether to change the MFR basis. No supporting evidence or statistics were supplied in the profession’s brief letter of 5 September 2001.

5.128. That being so, I am surprised that DWP did not seek more detailed evidence from the actuarial profession to support the profession’s view – along the lines of that which had been given by the profession in relation to their 1998 recommendation to make a similar change to the MFR.

5.129. Moreover, I recognise that GAD would have had access to discussions within the actuarial profession. However, I am not persuaded that the advice provided by GAD to DWP was sufficient in itself to enable DWP to ensure that the evidence base on which it took its decision was properly
documented and that the reasons for its decision were set out clearly.

5.130. While I accept that DWP asked GAD to provide a view as to whether DWP should accede to the actuarial profession’s recommendation, I consider that the advice provided by GAD can be read as being limited in a significant way.

5.131. GAD had been asked to provide advice on two questions: first, whether ‘events in the financial markets since 11 September [2001] mean that there is a case for taking action to change the MFR regulations to extend the deficit correction period in advance of the planned date of March 2002’.

5.132. Secondly, GAD was asked to give advice as to whether DWP should ‘accede to the request from the actuarial profession that the MFR equity MVA should be amended, by replacing the assumed long-term dividend yield of 3.25% with 3%’.

5.133. Thus, DWP had asked GAD for advice on one issue – related to proposals concerning the deficit correction periods – that was specifically limited to their view as to the effects of market volatility since the events in New York on 11 September 2001.

5.134. Its other request asked for advice on another issue – related to the proposal to amend the equity MVA – which was not time limited in the same way as the first, but which was related to GAD’s view as to the fundamental premise behind that proposal.

5.135. GAD provided detailed advice in response to the first request related to the deficit correction periods. This answered the question as put and provided evidence and analysis to support its advice. This was limited, as DWP had asked it to be, to an assessment of whether events in the two weeks since the attack on New York meant that it might be appropriate to bring forward the date on which the proposed changes should be made.

5.136. In relation to the second request for advice on whether the proposal to amend the equity MVA was appropriate, it is worth quoting here the GAD chief actuary’s response to that request in full:

*In our view, recent events – in and of themselves – do not undermine the thrust of the argument of the actuarial profession. Accordingly, GAD would agree that the change to the equity MVA proposed by the profession is justified as a simple change which adjusts the MFR to a level of protection consistent with that applying when the equity MVA was last adjusted in June 1998.*

5.137. I do not consider that it is clear from those two sentences whether the advice from GAD on the MVA proposal was limited to an assessment of whether events in the two weeks since 11 September 2001 had undermined the rationale behind the actuarial profession’s recommendation. If so, that was not what DWP had asked. DWP was concerned to establish whether the actuarial profession’s proposal was in principle appropriate.

5.138. In addition, if supporting analysis – equivalent to that done to support its advice on the proposal regarding the deficit correction periods – had been undertaken by GAD to support its advice on the proposal to amend the equity MVA, the chief actuary did not provide details of it.

5.139. Furthermore, it now appears from the Government Actuary’s response to this report (set out in annex D to this report) that the advice provided by the GAD actuary was not based on any independent assessment of the profession’s proposals but was rather based on the work that had been done by the actuarial profession.
5.140. GAD’s advice therefore gave no clear basis on which DWP could be satisfied that the rationale put forward by the actuarial profession in relation to the effect of events in the period prior to 5 September 2001 was in itself reasonable. Nor does it appear to have been supported by analysis other than that carried out by the profession itself.

5.141. It seems to me that DWP should have sought clarification so that it could document and confirm precisely what the scope of GAD’s advice was. In the absence of such clarification, DWP should have realised that they had not yet been given sufficient evidence on which to base their decision.

5.142. Moreover, it is surprising that, prior to recommending the MVA change to Ministers on 11 January 2002, no further analysis other than the advice from GAD (which appears to be limited to a consideration of events in the period from 5 September 2001 to 25 September 2001) was undertaken to establish whether the highly volatile economic conditions in the period following the attack on New York continued to have the effects on the strength of the MFR that had been ascribed to them four months previously.

5.143. It seems to me that, if it were possible for such significant changes to the MFR strength to occur over time – as it is claimed had happened in the period between 1 May 2000 and 5 September 2001 – then it was also possible that events between 25 September 2001 and 11 January 2002 (and beyond) may also have had such an impact – perhaps in a different direction.

5.144. This was a relevant consideration which was linked to the whole rationale for the actuarial profession’s proposal – the volatility of events – and one which therefore should have been analysed.

5.145. Indeed, I note that the actuarial profession, in its January 2001 response to the MFR consultation, had advised that the case for interim reform of the MFR ‘should be re-examined at the time any change is put forward, as... a different figure [for the equity MVA adjustment] may be supportable on the basis of subsequent movements’.

5.146. I also note the actuarial profession’s view now, which is set out in chapter 3 of this report, that ‘decisions about reacting to short term changes in the level of protection afforded by the MFR test were far from straightforward’ and that the Government had known this at the time.

5.147. It seems to me that this was precisely why a ‘considered and balanced’ assessment was necessary.

5.148. Regardless of what professional advice DWP had received, as this decision affected the funding of many private sector final salary pension schemes and as it was related to the security of the pension rights of many thousands of people, it seems to me that DWP should have done more to satisfy itself that it was right to implement this recommendation.

5.149. Did all of the above constitute maladministration? I consider that this decision was taken with maladministration as there is insufficient documentary evidence that explains the rationale for that decision – and as I have doubts about the reliance of DWP on professional advice which seems to me not to have been sufficient in itself to enable DWP to come to a decision that took account of all relevant considerations and which ignored irrelevant ones.

5.150. Thus my finding is predicated on what I consider to be failings in the process through which DWP took the decision – and in the
Findings – NICO handling of wind-up
5.151. I have set out the evidence uncovered by my investigation in relation to complaints about delays by NICO in the winding-up of schemes in chapter 3 of this report.

5.152. I am concerned that the process of winding-up routinely takes such a long time to complete and that the situation has not been improved in the almost seven years since the Government consulted on measures necessary to speed up the process. This routine delay has a detrimental effect on the monies available to secure the pension rights of scheme members.

5.153. Both the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF) believe that NICO is responsible for delays in the winding-up process – and also question the time I have found is taken by scheme administrators to inform NICO that their scheme is commencing wind-up.

5.154. The ABI told me that its members were:...
...firmly of the opinion that 14 months [the average time taken for a scheme administrator to contact NICO] is an inaccurately large figure and it is one which – universally – they do not recognise. Although periods of over one year and longer do occur on rare occasions, the average time is more in the range of 4 to 6 months. Our research suggests the problems, when they do arise, generally lie outside of the direct control of insurance companies.

5.155. NAPF told me, in a similar vein, that:...
...we would be astonished if it takes an average of 14 months to notify the surrender of a contracted out certificate. Evidence from our members suggests that 3 to 4 months is more typical.

5.156. On the role of NICO within the causes of delays to winding-up generally, NAPF told me that:...
...we estimate that roughly 50% could be attributable to NICO, although this varies from scheme to scheme. A scheme with good quality data might account for less than 50% while one with poor data might account for most of the delay.

5.157. The ABI listed a number of the causes of delay from their perspective. These included failures by employers or trustees to always return the necessary documentation and information in a timely fashion, which in their experience hindered scheme administrators – and also issues related to the time taken to appoint independent trustees and to deal with complex and often legal issues about pension entitlement and equalisation.

5.158. However, the ABI also said that NICO had a role to play among the causes of delay – principally in relation to the long-term effects of delays in confirming GMP entitlements and associated communication problems.

5.159. I have considered carefully the evidence before me. The statistical evidence I have analysed demonstrates that the fourteen month average is correct for the total workload NICO undertakes. Not all pension scheme administrators are members of the ABI or NAPF and it may be that their experience is not matched among those other administrators.

5.160. In any case, with respect to the random sample of 22 schemes we have analysed during the investigation, this pattern is broadly replicated – with a 15 month and 7 day average and a median of approximately 11 months. The position for the four representative schemes of which the lead complainants were members is,
however, slightly better – being an average of 11 months.

5.161. I also note that 22% of the respondents to a GAD survey of the administrators and trustees of pension schemes in wind-up, which was published in April 2004, had not reported that their scheme was in wind-up to the regulatory authority.

5.162. I do not doubt that the difficulties which NICO, the ABI and NAPF all highlight – related to the quality of records both at NICO and among scheme administrators, which both depend largely on the accuracy of those provided by sponsoring employers or trustees – play as important a part in the systemic delays I have identified as the time taken to notify NICO at the outset of the winding-up process. However, neither of these issues can be laid wholly at NICO’s door.

5.163. Having considered the available evidence, I am satisfied that, while on occasion things might have been done differently, NICO is not responsible for administrative error or other maladministration which is the root cause of this unsatisfactory situation.

Maladministration: summary of findings

5.164. I have made three findings of maladministration, namely:

(i) that official information – about the security that members of final salary occupational pension schemes could expect from the MFR provided by the bodies under investigation – was sometimes inaccurate, often incomplete, largely inconsistent and therefore potentially misleading, and that this constituted maladministration;

(ii) that the response by DWP to the actuarial profession’s recommendation that disclosure should be made to pension

scheme members of the risks of wind-up – in the light of the fact that scheme members and member-nominated trustees did not know the risks to their accrued pension rights – constituted maladministration; and

(iii) that the decision in 2002 by DWP to approve a change to the MFR basis was taken with maladministration.

Have individuals suffered injustice?

5.165. Having determined that maladministration did occur, I now turn to consider whether individuals have suffered injustice as a result.

5.166. As I explained in chapter 2 of this report, those who have complained to me claim to have suffered injustice which has four aspects:

(i) lost opportunities to make informed choices when considering pensions and savings options or to take remedial action in relation to the funding position of their scheme – due to misleading and incomplete information provided by public bodies and others about the risks involved in membership of a final salary scheme, which they promoted;

(ii) the financial loss of a considerable proportion (in some cases all) of their expected pension – once the wind-up of their scheme was triggered;

(iii) a sense of outrage – because the public bodies responsible for the framework of pensions law and regulation did not provide adequate protection through – or accurate information about the level of protection provided by – that framework; and

(iv) the distress, anxiety and uncertainty caused to them and their families – by the effects of the above.
5.167. It is clear to me from the evidence I have reviewed about the personal circumstances of all those who have complained to me that they and their families have suffered financial loss, a sense of outrage, and considerable distress, anxiety and uncertainty.

5.168. I am also satisfied that they have suffered injustice through an inability to make informed choices or to take remedial action. It is not in dispute that scheme members were not provided with full information about the degree of security afforded by the MFR; what this investigation has sought to establish was whether the information provided about these matters by official sources constituted maladministration.

**Has this injustice been remedied?**

5.169. Before considering whether the maladministration I have identified above was the cause of – or a contributory factor to – this injustice, I must first determine whether the injustice I have outlined has been remedied.

5.170. The FAS was established by the Government not in recognition that it had a legal liability or other responsibility for the financial loss which had been suffered by members of defined benefit occupational pension schemes – but as a means of providing, in the words of the then Minister, ‘significant help to those who have lost the most’.

5.171. This remains, however, the only attempt to provide support to – in other words, to remedy the injustice suffered by – those pension scheme members who have lost their expected pensions.

5.172. I am aware that, at the time of writing this report, payments have begun to be made to those covered by the FAS – more than one year after Royal Assent was given to the Pensions Act 2004. However, DWP tell me that:

... monthly payments are now being made to 24 scheme members in four different pension schemes following applications from their scheme trustees... These are all “initial” payments at 60% of expected pension rather than final payments at 80%... [such] payments have been introduced to ensure people do not have to wait until their schemes fully wind up before getting help. The level is set at 60% to seek to avoid people being overpaid and then being required to pay money back once their scheme has wound up.

5.173. That being so, it cannot be said on the basis of these few payments at the rate that they are being paid that the FAS has already remedied the injustice claimed by complainants.

5.174. But what of whether the FAS will remedy such injustice once it becomes fully operational? I am quite clear that the FAS will not constitute an adequate and appropriate remedy for the injustice claimed by those who have complained to me, for the following reasons:

- first, it does not cover the position of those members of a final salary scheme where the sponsoring employer is still trading or otherwise is not insolvent;
- secondly, it only provides at maximum 80% of the ‘core benefits’ expected by those scheme members it covers – it is payable to bring the total pension received by a member up to that figure;
- thirdly, ‘assistance’ is only available to those members within three years of scheme retirement age at 14 May 2004 and, in most circumstances, only from the age of 65 – regardless of normal scheme retirement age;
- fourthly, ‘assistance’ is to be paid at a fixed rate for life with no increases;
- fifthly, ‘assistance’ is subject both to a *de minimis* lower threshold (of £520 per year – below which nothing will be paid) and an upper limit on the ‘assistance’ to be paid (of £12,000 per year); and
• finally, there is to be no payment of ‘non-core’ benefits, such as in respect of additional contributions or for life cover. In addition, widows will only receive half their deceased spouse’s FAS entitlement.

5.175. I am therefore satisfied that an injustice exists, which has not been – or which it is not intended will be – remedied. I now turn to assess what were the causes of the injustice I have outlined above.

What caused this injustice?

5.176. It seems to me that it must be common ground that the trigger for the financial losses incurred by complainants and others in a similar position to them was the winding-up of their scheme with insufficient funds to meet its full liabilities to all its members – in other words, the scheme’s inability to meet the ‘pensions promise’ to all of its members.

5.177. However, I have found that those responsible for the legislative and regulatory frameworks within which final salary occupational pensions are provided did not adequately disclose the true position as regards the degree of protection offered to scheme members in such circumstances by the legislative and administrative provisions Government was responsible for establishing, operating and enforcing. I have also found that DWP took certain relevant decisions with maladministration.

5.178. In addition, as should be clear from above, the injustice claimed by complainants does not only consist of financial loss – although of course that is a significant component of the injustice they have suffered.

Informed choice and lost opportunity to take remedial action

5.179. I will turn first to the lost opportunities to make informed choices about saving for retirement and to take remedial action in relation to the funding of their pension scheme.

5.180. It seems to me that, had individuals had all the information they needed, they would have been able to make properly informed choices about the options – whether in relation to membership of their scheme or to seek to remedy funding issues concerning their scheme – that were open to them.

5.181. It is clear to me that they were not aware that questions needed to be asked – other than to ensure that their scheme met the MFR test. I consider that these lost opportunities flowed directly from that lack of knowledge and from a ‘false sense of security’.

5.182. Furthermore, I am satisfied that official information promoted the reasonable belief that, so long as a scheme was funded to the MFR level, it would be able to meet its liabilities to all its members in full.

5.183. Government had given itself responsibilities to properly inform citizens about their pension options – and told them that these responsibilities were supported by its publications. In addition, an ability to make informed decisions was an objective said by Government to be one that it saw as being supported by such official information.

5.184. It seems to me that Government assigned these responsibilities to itself – and told others that it had done so. In addition, it was Government policy to promote membership of an occupational scheme and it also chose to do that.

5.185. In that context, therefore, I consider that it was all the more important that official sources should have provided clear, balanced and appropriate information about the options open to people to enable them to ask the correct
questions to help them fulfil the ‘obligation’ to save that the Government told them they had.

5.186. Taking all of the above into account, I am satisfied that this form of injustice – these lost opportunities – was caused by the incomplete, inconsistent, unclear, and often inaccurate information given to scheme members, trustees and sponsoring employers through official sources.

**Outrage and distress**

5.187. What caused the sense of outrage to individuals whose pension schemes have wound up without sufficient funds to meet all its liabilities to them?

5.188. I recognise that those who have complained to me also feel a sense of outrage towards – and have been distressed by – those who chose to close down their scheme – or, in respect of those schemes which wound up due to the insolvency of the sponsoring employer, by the circumstances which caused them to lose their job and their pension. Those are not matters for me.

5.189. However, as the Prime Minister recognises in the Foreword to the Ministerial Code, there is a ‘bond of trust’ between the British people and their Government. It seems to me that citizens should be entitled to expect that the publications of official bodies – which create, oversee, administer and enforce the legal frameworks which they are told are there to protect their interests – do not mislead them.

5.190. I am satisfied that the individuals who have complained to me have suffered a sense of outrage that they see as the failings of a system of regulation and control that they were told would act quickly to protect their interests, would provide a secure environment for their pensions so that another ‘Maxwell’ could not happen, and would provide the information necessary to enable them to make perhaps the most important financial decisions of their lives.

5.191. Finally, having reviewed many submissions from those affected, I am satisfied that the stress, distress and uncertainty that the individuals who have complained to me have suffered was caused to a significant degree by the shock that they felt when what they never knew might happen to their pensions did occur – and when they realised that the official assurances that they had trusted proved to be misplaced.

**Financial loss – the context**

5.192. In my view, maladministration caused injustice in the manner set out above. But what of the financial loss incurred by those individuals?

5.193. I recognise that such losses were crystallised – and, in many cases, exacerbated – by events that occurred within a system of occupational pension provision which had many components other than the administrative actions of the public bodies considered in this report.

**Exacerbating loss – delays in winding-up**

5.194. I consider that, whatever the cause of the financial losses suffered by complainants, the many years that it routinely takes to wind up a final salary scheme generally exacerbate the financial losses suffered by those whose scheme winds-up without sufficient funds to meet all of its liabilities.

5.195. The longer it takes to complete winding-up, the more professional and other fees are incurred by the scheme. These take priority over scheme benefits and are deducted before the assets of the scheme, once realised, are distributed among scheme members.
5.196. While I have not found in this investigation that the cause of these delays was maladministration on the part of NICO, I consider that these delays are an inherent part of the system of winding-up final salary schemes.

5.197. Those delays are the responsibility of everyone involved in the system, including NICO and OPRA (or those now undertaking OPRA’s relevant functions).

The causes of financial loss
5.198. But how were such losses caused in the first place? As I have explained above, the financial losses sustained by complainants (and others in a similar position to them) were triggered by the wind-up of their scheme in such a position as to be unable to honour the ‘pensions promise’ to all its members.

5.199. That trigger – the winding-up of schemes – clearly was not caused by deficiencies in official information about pension security. I consider that there are a number of aspects of the system of occupational pension provision which are relevant when seeking to explain the cause of the financial losses suffered by those who have complained to me.

The actions of some employers
5.200. First, it is clear that the voluntary decisions by some ongoing and solvent firms to close their schemes led directly to a situation where those schemes ended up with insufficient funds to meet all their liabilities, as these – often unexpected – decisions triggered the winding-up of the scheme.

5.201. In addition, where a company has become insolvent, it is sometimes the case that the company had not by that time made all of the contributions due to the scheme and that, on insolvency, there was little money left to rectify the scheme’s resulting funding deficit.

5.202. In some senses, these decisions (or events) are the responsibility (or the misfortune) only of the companies themselves.

5.203. However, I note that the law allowed companies to voluntarily close schemes, although in later years more restrictions were placed on this right.

5.204. I also note that, even where a sponsoring employer was deemed to have responsibilities in law to put in additional funding to their scheme, until 19 March 2002 the law only required them to bring the scheme’s funding level up to the MFR level – and even then, only over time. It was not until 15 February 2005 that all pension schemes were able in law to seek to recoup the full costs of buying-out pension liabilities from sponsoring employers, whether the latter were still solvent or not.

5.205. As I have established in this report, the position prior to this did not mean that the financial losses sustained by the relevant complainants would not have occurred. This is because where an employer discharged in full its legal liabilities in relation to scheme funding this might still have led to significant – but lawful – shortfalls.

5.206. Thus the actions or demise of some sponsoring employers led directly to the initiation of the wind-up of the scheme – with associated significant funding shortfalls in some cases which led to some of the losses to some scheme members.

5.207. However, even where an employer had fulfilled all of its legal responsibilities to its scheme and had put in enough funding to bring it up to the MFR level, this did not necessarily mean that no losses have been incurred by the scheme’s members.

5.208. The actions of employers alone cannot therefore explain what caused the financial
losses incurred by complainants. If such losses occurred in situations where an employer fulfilled all of its legal responsibilities to a scheme, what other factors contributed to these losses?

The legal framework

5.209. Secondly, I consider that certain provisions of the law itself had a direct impact on the circumstances in which the losses I have outlined in this report took place. Government developed the statutory framework which governed the matters which have formed the subject matter of this investigation. Parliament enacted those laws.

5.210. There are five aspects of the relevant legal framework which are relevant to situations in which certain schemes wound-up with insufficient assets to meet all of their liabilities to all of their members:

(i) the provisions of the statute and subordinate legislation that governed the MFR established the context in which financial loss was – quite lawfully – able to occur. These included the design of the MFR itself, the provisions that allowed companies to make up funding shortfalls over some considerable time, and also what was prescribed as being required to be disclosed to scheme members;

(ii) the legal provisions which allowed employers to take ‘contribution holidays’ during periods when scheme funding was strong is also relevant. I note that there were little restrictions on such ‘holidays’, which in some senses reinforced the effect of the provisions which enabled funding shortfalls where identified to be made up over some time;

(iii) the law relating to tax relief and the removal of such where schemes were deemed to be significantly ‘over-funded’ may also have been relevant to some schemes, as it acted as a potential disincentive to provide additional funding in periods when a scheme was not ‘under-funded’;

(iv) the law relating to the insolvency of companies is also relevant, in that its provisions meant that pension schemes were unlikely to be able to obtain monies due to them from sponsoring employers because of the low and unsecured priority afforded to schemes. I note in this context that, prior to 15 September 2003, certain public bodies had preference when the remaining assets of such companies were distributed to its creditors; and

(v) the statutory priority order is also relevant, as it prescribed how a pension scheme’s assets should be distributed on wind-up.

5.211. However, it should be recognised that the law itself reflected the policy intention of Government and the will of Parliament – and also decisions made by Government, approved in some cases by Parliament, to make changes to the legal framework over time.

Policy decisions taken by Government

5.212. Therefore, thirdly, it is evident that certain policy decisions by Government – which were discretionary and which I have not investigated – played a significant role in the context in which the financial losses suffered by complainants occurred.

5.213. In October 1998, briefing by officials in DWP’s predecessor department had recognised that the decision in the 1997 Budget to abolish the system of tax credits given to pension schemes had ‘shaken’ pension scheme funding. In November 1999, DSS officials told a Minister that that decision had ‘had the effect of weakening the MFR test as prescribed at that time’.
5.214. I consider that it is evident that this decision had the effect of reducing the income available to all pension schemes every year. It also appears that, at least to DSS officials at the time, this decision weakened the protection offered to scheme members by the MFR. This also had a differential impact on those schemes which were already less well funded. While I note that there were compensating provisions established at the same time, these related to relieving the tax burden on the sponsoring employer – and did not relate to the pension scheme. DWP tell me that these provisions were designed to produce positive changes in behaviour and, as such, it is difficult to be certain of the benefit to pension schemes. Nevertheless, I consider that this decision is of relevance to the subject matter of this report.

5.215. Furthermore, the Government chose, at the same time as the second decision to weaken the MFR basis in 2002, to extend the periods during which sponsoring employers had to make up shortfalls in their contributions to bring a scheme up to the MFR level. This meant that, where a scheme was not funded to the MFR level, employers could quite properly take up to ten years to rectify the position. If in the meantime an employer became insolvent, this decision might have been highly significant.

5.216. In addition, while I have not found that the 1998 decision to weaken the MFR basis was one taken with maladministration, I consider that it is evident – not least from parliamentary answers given in July 2003 – that that decision had the effect of reducing the amount of money that had to be paid into pension schemes. This led to schemes operating prior to wind-up with fewer assets than they would have had a legal right to claim had this decision not been taken.

5.217. It is not for me to question whether these policy decisions were appropriate. I have sought instead to ascertain whether they – with other factors – were a relevant part of the wider context in which the financial losses suffered by those who have complained to me occurred.

5.218. Having considered the available evidence, I am satisfied that these decisions played a significant contributory role in the context in which the financial losses suffered by complainants occurred. Those decisions are, of course, the responsibility of Government.

The role of maladministration in creating financial loss

5.219. The above four factors – delays in the winding-up process, the actions of some employers, the nature of the relevant legal framework, and some of the Government’s policy decisions – all relate to key component parts of the system within which final salary occupational pensions were provided.

5.220. The actions of scheme trustees, administrators and their professional advisers were another factor in this system. I note, however, that the law provided for compensation to be paid to remedy financial loss attributable to the unlawful actions of those responsible for schemes.

5.221. While it is not for me to question the merits of this system, or to make findings in relation to any of those factors, it seems to me to be impossible to determine the degree to which the maladministration I have identified in this report has contributed to the financial losses incurred by complainants without some consideration of these other factors.

5.222. It may well be that the systemic features that I have outlined above played a significant role in enabling the financial losses sustained by complainants and those in a similar position to them to occur. Parliament, Government and
others may wish to reflect on the degree to which these factors were relevant.

5.223. However, I must ask whether maladministration played any role in bringing about financial loss.

5.224. Before considering this, I should say that my assessment of this question which follows is limited to the effects of the deficiencies in official information that I have identified.

5.225. It is clear that reducing the level to which a pension scheme had to be funded – to maintain the Government’s policy intention, albeit not one properly disclosed to scheme members – may have had an effect on the circumstances relevant to the financial losses suffered by complainants. The 2002 decision to change the MFR basis – like the earlier decision in 1998 – may thus have had an indirect effect on the injustice suffered by members of some schemes.

5.226. Where I identify maladministration, it is my usual practice to seek to put individuals back into the position they would have been in had that maladministration not occurred. Taking that approach to the maladministration I have identified in relation to the March 2002 decision, it seems to me that, had the decision-making deficiencies not occurred, this would have made no material difference to the degree of knowledge that scheme members had – which in my view is at the heart of these matters. That decision would have still been taken – only on a proper basis.

5.227. That is why my assessment which follows is restricted to considering the impact of the failure by public bodies to disclose risk and to properly inform scheme members of the degree of security they could expect from their scheme being covered up to the MFR level.

5.228. Had the members of schemes known fully the risks to their pensions, I consider that many of their financial decisions would unquestionably have been different.

5.229. For example, it seems to me highly likely that those who transferred pension entitlements into their scheme from that of a previous employer or from another savings vehicle would have wanted to spread the risks to their financial future and would most likely have decided to leave their entitlements where they were.

5.230. Others, those who had money available to make further pension provision – as recommended by Government – would most probably have chosen not to make additional voluntary contributions to the scheme but would instead have sought to spread the risks by investing that money elsewhere.

5.231. Had this maladministration not occurred, there were a number of things that scheme trustees, members and sponsoring employers could have done – and in my view any reasonable person most probably would have done. These actions would have had as their aim the significant improvement of the financial position of a scheme or the diversification of individual risk. If successful, such actions might have prevented or minimised the financial losses suffered by members in relation to the pension and other benefits derived from national insurance contributions and their contributions to the scheme itself.

5.232. Had official information about the degree of protection afforded by the MFR and the resulting risks to members’ pension rights been accurate, complete and consistent, I consider that the actions I discuss in more detail in annex C to this report might well have ameliorated the financial position of schemes and would therefore most probably have led to lesser, if any, financial loss of this type.
5.233. These actions include the facts that:

(i) scheme trustees could have opted for a ‘gilts-matching’ investment strategy which would have maximised the contributions made to the scheme by employers, which would have had a clear impact, especially in the cases where the scheme was not wound-up in due course due to the insolvency of the employer;

(ii) scheme members could have pressured employers to raise contributions, perhaps through their organised representatives; and

(iii) sponsoring employers could have sought to make additional arrangements – perhaps through merger with other businesses or by attracting new capital – to enable them to be able to increase the contributions to their schemes.

5.234. I have found that Government provided incomplete, inconsistent, misleading or inaccurate information about the degree of protection that the law provided.

5.235. Even what was intended by the MFR was not properly disclosed by the Government to scheme members in official information leaflets until April 2004, although it had been indirectly alluded to – or on occasion been set out in broad terms – in other official publications or statements since September 2000. I consider that these failings led to the members of schemes and others being unaware of the need to take any of the possible forms of remedial action that I have outlined above.

5.236. These lost opportunities were the result of the maladministration I have identified in this report and, in my view, contributed directly – with other factors – to the situation in which the loss of pensions and other benefits which were to be derived from the members’ contributions to their scheme were able to occur.

5.237. Members at the same time also lost the pension derived from their national insurance contributions, described by Government in relation to the majority of the relevant period as a ‘Guaranteed Minimum Pension’ which, had they not contracted out, would have remained within the State additional pension system and would now still be safe. Knowledge of the risks might also have influenced individual decisions on contracting-out.

5.238. I consider that the financial loss of pensions derived from contributions either direct to schemes or by way of national insurance contributions was therefore a consequence of the maladministration I have identified – as well as of the other contributory factors I have identified above.

5.239. But what of whether that maladministration caused injustice? It seems to me that the financial losses suffered by complainants did not come about as a result of the workings of a system about which individuals had been properly informed – and where the risks inherent in that system had been highlighted to them clearly by those responsible for it.

5.240. On the contrary, the financial losses incurred by complainants were crystallised before those individuals even knew that such an eventuality might befall them and in a context where they had had no warning to enable them to take remedial action or to otherwise protect their position.

5.241. That seems to me to be a clear injustice. Not only did those individuals trust the information they were provided with about the framework put in place by Government to protect their pensions, they were unable to properly consider their financial position or to make fully informed choices about their pension options.
5.242. They were also unable to consider what action they could take to remedy the financial weakness of their scheme, as the official information given to them was deficient.

5.243. Official information effectively distorted the reality of the position in which scheme members found themselves. As a result, they were wholly unaware that their pension rights were dependent on the ongoing security of the employer sponsoring their scheme.

5.244. That constitutes an injustice which was caused by maladministration. While I cannot say that maladministration alone caused the financial loss suffered by complainants, I do consider that it was a significant factor in creating the environment in which those losses were crystallised.

Injustice: summary of findings

5.245. I have found that injustice — in the forms of a sense of outrage, lost opportunities to make informed choices or to take remedial action, and distress, anxiety and uncertainty — was caused by maladministration.

5.246. I have also found that the maladministration I have identified was a significant contributory factor in the creation of the financial losses suffered by individuals, along with other systemic factors. A further consequence of that maladministration was financial injustice — the distortion of the reality facing scheme members so that they were wholly unaware that their pension rights were dependent on the ongoing security of their employer.
6. Recommendations

Introduction
6.1. In this chapter, I make recommendations to put right the injustice that I have found remains to be remedied.

6.2. Before setting out my recommendations, I will first describe the remedies that complainants are seeking. I will then set out my understanding of who might be fully covered by any recommendations that I make.

6.3. Once I have set out my recommendations, I will make a number of further observations about the subject matter covered by this report which have been informed by the evidence I have reviewed during this investigation.

Remedies sought
6.4. Complainants have sought through my investigation financial redress for the injustice they have suffered and also financial recognition of the outrage, distress, inconvenience and uncertainty that they have endured.

6.5. They have also sought a full explanation of what has happened to them. I hope that my report has now provided that explanation.

6.6. In terms of the financial remedies sought, these can be placed into three distinct categories:

(i) financial redress that would provide complainants with the pension (including that deriving from additional voluntary contributions) that they would have received from their scheme had it not wound up without sufficient funds to meet all of its liabilities – we might call this core pension replacement;

(ii) financial redress that would replicate ‘lost’ associated benefits – such as life cover, survivor benefits, and ill-health benefits – that have in some cases already been foregone by many of the complainants and

in other cases will in future necessarily be foregone – we might call this the restoration of non-core benefits; and

(iii) financial redress to provide tangible recognition of the effects of the maladministration that I have identified on complainants and their families – we might call these consolatory payments.

Who is covered by my recommendations?
6.7. The maladministration I have identified in this report occurred in the period from January 1996 until April 2004 – being the period from when the first deficient official leaflet on the Pensions Act 1995 was issued until official leaflets aimed at the public were issued that were broadly accurate.

6.8. However, I am aware that the first official leaflet was describing a regime – which included the protection offered by the MFR – which was only to come into force in April 1997. I do not consider that anyone who read that leaflet, which purported to explain the future protection that would be provided by the MFR, could expect that that protection would extend to those schemes which wound-up before the date on which the MFR was said to come into force.

6.9. In light of the above, I have considered who should be fully covered by the recommendations I go on to make. I have determined that my recommendations should apply to those individuals:

(i) who are or were a member of a final salary scheme which commenced wind-up from 6 April 1997 to 31 March 2004; where

(ii) their scheme wound-up with insufficient assets to secure pensions in payment and to pay cash equivalent transfer values in respect of full accrued pension rights to all
non-pensioner members or to secure the full liabilities for each non-pensioner in other ways; and where

(iii) the scheme is not eligible for the pensions compensation scheme – because it has not suffered losses wholly attributable to fraud or other unlawful behaviour; and where

(iv) the individual has incurred an actual financial loss because of a shortfall in the pension promised in respect of any or all of the following:

- the contributions made by them and/or their employer to the scheme (that is, the scheme pension); and/or
- contracted-out national insurance contributions that were rebated to the scheme (that is the ‘Guaranteed Minimum Pension’ and similar provision – which, despite its different provenance, was due to be paid with the scheme pension); and/or
- other benefits due (such as survivor benefits and life cover).

My recommendations

6.10. Having set out the remedies sought and those who are covered by my recommendations, I now turn to set out what I consider should be done to remedy the injustice I have found was caused by maladministration.

6.11. In making these recommendations, I consider that the following should be recognised:

- first, that, while I have found that maladministration has caused injustice, I have also found that, insofar as the financial losses suffered by complainants are concerned, maladministration was one of a number of factors which led to the circumstances in which those losses were sustained;
- secondly, that, as a result, I cannot say that maladministration alone caused the financial losses suffered by complainants – although I consider that maladministration was a significant factor among the causes of those losses;
- thirdly, that, accordingly, those public bodies responsible for that maladministration cannot be held solely responsible for the financial losses sustained by complainants;
- fourthly, that, nonetheless, I consider that the contribution of public bodies to the circumstances in which those financial losses were sustained went beyond the maladministration I have identified. Through the policy behind – and the provisions of – the legal framework and certain decisions concerning both, those public bodies played a significant role in the factors which led to the financial losses sustained by complainants; and
- finally, that, leaving strict responsibility aside, I consider that the position of those individuals who have lost a significant proportion – in some cases all – of their accrued pension rights should not be forgotten among all of these considerations. Neither should it be forgotten that one form of injustice was caused by maladministration in the form of the distortion of the reality underpinning the financial security of pension rights.

6.12. In the light of the above, it seems to me that those responsible for responding to my report should consider whether – in addition to their responsibility to remedy the injustice caused by the maladministration I have found – there exists for other reasons a moral imperative to put right the devastating effects of events wholly beyond the control of the people so deeply affected by them.
6.13. It is with that in mind that I offer the following recommendations.

First recommendation
6.14. My first recommendation relates to remedying the financial injustice suffered by those who have complained to me and also those in a similar position as those individuals.

6.15. I recommend that the Government should consider whether it should make arrangements for the restoration of the core pension and non-core benefits promised to all those whom I have identified above are fully covered by my recommendations – by whichever means is most appropriate, including if necessary by payment from public funds, to replace the full amount lost by those individuals.

6.16. I recognise that this would be a significant commitment, although it seems to me that it would be a commitment that could be discharged over a number of years if the right means were identified and that this would be a commitment that would decline over the years.

6.17. I recognise that it may be felt by the Government that it is possible to mitigate the cost to the taxpayer of pension replacement from monies due from other bodies – particularly any that they consider played a significant role in the relevant events. If that is so, I consider that the Government should reflect on whether it would be more appropriate for it to take action itself – rather than to expect individual scheme members or trustees to do so – to recoup such sums using the considerable collection and enforcement powers that Government has.

6.18. I am aware, in addition, that the relevant pension schemes have assets that could assist pension replacement and that alternatives to securing pension liabilities for members of the affected schemes through the purchase of annuities have been suggested. These alternatives, as I understand matters, would still require Government action.

6.19. I recognise that asking the taxpayer to meet part or all of the cost of this recommendation raises significant public policy questions. However, I believe that the Government should consider whether its response to my recommendations should have regard to what might be considered by many – and certainly by some of the people who have complained to me – to be a precedent.

6.20. I note that Government has recently recognised that, even though there may be significant financial implications, it should honour the pension arrangements for existing public sector employees as those people have made employment, financial and other choices based on the information that they were given about such arrangements in the past. New entrants to the public services are to have significantly less attractive arrangements which will be made clear to them prior to entry.

6.21. It seems to me that there are some parallels with the position of those whose pension entitlements were crystallised prior to the introduction of the new pension protection arrangements in April 2005.

6.22. Those who have complained to me were also given information in the past about their pensions. They were told that their pensions were safe, guaranteed and protected by law – and they acted accordingly. It seems to me that sympathetic consideration should be given as to whether those assurances should now be honoured.

Second and third recommendations
6.23. My second and third recommendations relate to the recognition of the effects of the maladministration on those who have suffered as
a result – and are directed in different ways at scheme members and scheme trustees.

6.24. **I recommend that the Government should consider whether it should provide for the payment of consolatory payments to those scheme members fully covered by my recommendations – as a tangible recognition of the outrage, distress, inconvenience and uncertainty that they have endured.**

6.25. **I also recommend that the Government should consider whether it should apologise to scheme trustees for the effects on them of the maladministration I have identified, particularly for the distress that they have suffered due to the events relevant to this investigation.**

6.26. I recognise that it may not be possible to make a personal apology to every trustee concerned, not least because it would be very difficult to identify them. However, I consider that those people rightly feel that their professional reputations have suffered and I believe that official regret for this should be publicly stated.

**Fourth recommendation**

6.27. My fourth recommendation relates to those people who otherwise would be fully covered by my recommendations but whose scheme began wind-up between 1 April 2004 and 6 April 2005, when the new pension protection arrangements replaced the regime covered by my investigation.

6.28. **I recommend that the Government should consider whether those who have lost a significant proportion of their expected pensions – but whose scheme began wind-up in the year prior to the new regime becoming operational – should be treated in the same manner as those fully covered by my recommendations.**

6.29. In doing so, I recognise that, by this time, official information provided to the public was broadly accurate and that it could therefore be said that there was an opportunity for such individuals to take whatever action they could to mitigate their potential loss.

6.30. However, I nevertheless consider that the Government should also give sympathetic consideration to the position of those whose scheme began wind-up in this year.

6.31. I believe that there are two grounds for such consideration. The first is that it should be recognised that, by the time the official information was rectified, it was probably too late for many of those people within this group both to seek to take some of the remedial actions that I have identified were open to them – and also for such action to have had any effect. In addition, some of the losses suffered by this group of people may not have been recoverable even had such action been undertaken, as there would have been little time to transfer out prior to wind-up.

6.32. Secondly, it may be that any decision not to include this group of people would lead to the introduction of considerable and unnecessary administrative complexity – and a feeling of further unfairness – into whatever scheme is adopted.

**Fifth recommendation**

6.33. My fifth recommendation relates to the process of winding-up final salary occupational pension schemes.

6.34. **I recommend that the Government should conduct a review – with the pensions industry and other key stakeholders – to establish what can be done to improve the time taken to wind up final salary schemes.**
6.35. The factors which together account for the often considerable time it takes to wind up such schemes appear to have been the subject of consensus for many years.

6.36. I am conscious that the Government’s initial response to the relevant head of complaint in this investigation contained an almost identical list of factors that it considered were pertinent as that provided by Government in its May 1999 consultation on the same matters. Those representing scheme administrators appear to concur in that view – as do those independent trustees who we interviewed during the course of this investigation. Furthermore, the Government’s initial response to the complaints I have investigated also maintained that delays were attributable to ‘the nature of the process’.

6.37. That being the case, I consider that action should be taken urgently – by Government in partnership with others in the pensions industry – to establish what could be done to ameliorate this unsatisfactory situation.

Other observations

6.38. Having set out my findings and recommendations, I wish to make two further observations concerning the subject matter of this report which have arisen from the evidence I have reviewed during this investigation.

Pension language

6.39. First, it is apparent from all of the publications that I have examined that the language used by pensions professionals and related public bodies has often been unclear.

6.40. Examples include terms such as ‘Guaranteed Minimum Pension’ – which in the circumstances covered by this investigation proved to be neither ‘guaranteed’ nor a ‘minimum’ – and in some cases would not even provide any pension at all. Another example is ‘under-funded’ – which to the Government meant not that a scheme had insufficient funds to meet its liabilities, but rather related to a scheme’s relative position against the varying basis for the MFR.

6.41. It may be that the Government and all those involved in the pensions industry might wish to consider together how best to ensure that language which has a natural and commonsense meaning to most people is not used in relation to pensions in such a way as only to have a narrow, technical and potentially misleading meaning.

The Financial Assistance Scheme

6.42. Secondly, I have begun to receive enquiries from people who wish to complain about the administration of the Financial Assistance Scheme (FAS) beyond the matters covered by this investigation.

6.43. These appear to be mostly related to the underlying policy behind the FAS or to constitute ‘appeals’ against the operation of the scheme in relation to particular schemes or individuals. However, I have also received complaints that DWP Ministers and officials have not answered reasonable questions about the FAS. I will consider those complaints following publication of the report – and in the light of the Government’s response to my recommendations.

6.44. Leaving this aside, it is also clear to me from what complainants in this investigation have told me that many people have been distressed by not being covered by that scheme or, if they are, at the amount of ‘assistance’ that they might receive.

6.45. In addition to this, I am acutely aware that many people have also been distressed by two other aspects of the FAS. These are the language used – ‘assistance’ has deeply negative connotations for many people and also does not recognise that what they seek is the
‘replacement’ of their pension, lost through no fault of their own – and the lack of clear eligibility criteria from the outset of the scheme.

6.46. I recognise the need for proper planning and preparation time before a particular scheme becomes fully operational. However, I am concerned that the FAS eligibility criteria were only announced and clarified over many months and that this has added to the uncertainty and distress felt by those affected.

6.47. In the light of my recommendations above, it is possible that the FAS may need to be reviewed fundamentally in any case. I would hope that part of any such review would deal with the language used.

6.48. In addition, I would hope that any lessons learned from this experience would be fed into whatever arrangements are established by the Government as a result of this report.

6.49. Given all of the above, it may be that I will not need to consider further those complaints about the FAS that I have recently received.
7. The Government’s Response to My Findings

Introduction

7.1. I recognise that the implications of what I have recommended are significant and might require a considerable amount of cross-Government discussion and consideration. I therefore asked the Government to respond to my report in two stages.

7.2. I asked the Government first to respond to my findings and to address those prior to publication of my report. I asked the Government, once that was done, to formally respond to my recommendations within two months of the publication of my report.

7.3. I received responses to my findings on 27 January 2006 from Her Majesty’s Revenue and Customs and from DWP. The Government Actuary made a submission supplementary to that made by DWP. The Pensions Regulator confirmed that they wished to make no representations on my report as it related to their predecessor body, OPRA.

7.4. Annex D to this report sets out the initial response of DWP and the Government Actuary to my report. At their request, this is done in their own words, with only minor editing.

7.5. Annex E to this report sets out the response of Dr Ros Altmann, on behalf of complainants, to my report. Again, this is done primarily in her own words.

7.6. The rest of this chapter does four things: first, it sets out the response to my report from Her Majesty’s Revenue and Customs; secondly, it sets out my assessment of the Government’s initial response to my report (see annex D); thirdly, it sets out the further response to my report that was provided at my request by DWP in response to my assessment of their initial response; and, finally, it sets out my consideration of the Government’s further response to my report.

Response of Her Majesty’s Revenue and Customs

7.7. The Chairman of the Board of Her Majesty’s Revenue and Customs said that he welcomed the fact that I had not upheld complaints about maladministration by NICO in the process of winding-up final salary pension schemes.

7.8. He said that his Department had noted my concern about the routinely lengthy time it takes to wind up schemes and also my recommendation that the Government conduct a review to establish what could be done to speed this process up.

7.9. The Chairman said that he also welcomed that recommendation and that his Department stood ready to participate fully in any such review.

7.10. He also informed me that NICO had initiated a new project, which was fully supported by the main pensions industry representative bodies. He said that they had embraced the opportunity to collaborate with his Department.

7.11. The Chairman told me that this initiative aimed to reduce the time it takes to wind up final salary schemes and involved the development of a system that would enable the electronic exchange of data between NICO and those scheme administrators who choose to use it within a secure IT environment. It was hoped that this would be tested through a trial with scheme administrators in the first half of 2006.

7.12. I welcome the positive response of Her Majesty’s Revenue and Customs to my report.

DWP’s initial response

7.13. As is explained above, the response of DWP to my report is set out in annex D to this report.

7.14. In seeking to summarise that response (and the supplementary submission of the
Government Actuary), it seems to me that their representations revolve around four principal headings: the quality of the content of official information; the role that such official information could reasonably be said to have played in the events relevant to this investigation; my finding related to the 2002 decision to change the MFR basis; and questions of causality between any shortcomings in official information and any injustice suffered by complainants.

The content of official information
7.15. The Permanent Secretary told me that DWP believed that my report did not substantiate findings that official information issued about the level of security provided by a scheme being funded to the MFR level was not consistent, accurate or complete – nor that the failure of DWP to review existing leaflets, after it was told that people did not know of the risks to their accrued pension rights, constituted maladministration.

7.16. In support of this view, he said that my report had had insufficient regard to four propositions:

(i) that ‘Ministers and others repeatedly stressed that the MFR was intended to provide “greater” protection rather than any absolute guarantee’;

(ii) that ‘it was repeatedly stressed that the MFR was intended as a balance between the interests of scheme members and employers’;

(iii) that ‘all of the leaflets to which the report refers carried a general health warning that they were not complete explanations of the law and were for general guidance only’; and

(iv) that it had always been accurate for official information to state that ‘most members of an occupational pension scheme would be better off when they retire than they would be if they did not join it’.

The role of official information
7.17. DWP said that, for a number of reasons, it was their view that ‘given the wide range of sources of information available to the complainants, and the very general nature of the Departmental publications, it is unlikely in the extreme that [official] publications would have materially influenced’ the actions of complainants.

7.18. Those reasons included:

(i) that only approximately half of the respondents to my survey could demonstrate that they had seen the relevant official publications;

(ii) that there was no substantial evidence that, even where an individual had seen the relevant publications, they had acted differently from how they would otherwise have acted; and

(iii) that it could not be assumed that individuals who had acted differently as a result of reading official publications had been entitled to do so, in a position in which the primary responsibility for safeguarding the interests of scheme members lay with scheme trustees.

The 2002 MFR decision
7.19. DWP told me that it did not consider that my report substantiated a finding of maladministration in relation to the 2002 decision, for the reasons set out in annex D to this report.

7.20. In the light of those reasons, DWP could not agree that they had not given proper consideration to the issue. The Government Actuary said that he agreed with this assessment.
Causality

7.21. DWP also told me that they do not accept that the necessary causal link had been demonstrated between any maladministration and the losses incurred by complainants.

7.22. They said that they found the examples given in my report of actions that properly informed scheme members, trustees or sponsoring employers might have taken were ‘unconvincing’, because:

(i) the suggestions that accurate official information on scheme security might have led to different action by employers ‘are wholly speculative’;

(ii) my report did not recognise the uncertainty that any remedial action taken by scheme trustees or members would have had any effect;

(iii) there was no evidence that many of the complainants’ decisions would have been unquestionably different had they known the true position; and

(iv) an individual who, knowing the potential risks to their final salary pension, chose to transfer out into, for example, a personal pension might have suffered a loss if their final salary scheme never wound up ‘under-funded’.

7.23. In summary, DWP said that my report did not acknowledge sufficiently the ‘myriad uncertainties’ which attach to any consideration of ‘how outcomes might have differed if the specific actions criticised had been undertaken differently’.

7.24. The Permanent Secretary continued:

Given the number of causal factors at work, the vast majority of which fall wholly outside the scope of [my] jurisdiction (and indeed wholly outside the Government’s control), the Department would suggest that the only rational conclusion is that the matters criticised, even if (which we do not accept) such criticisms were justified, are unlikely to have made any difference to the outcomes for the individual complainants.

My assessment of the response from DWP

7.25. I am not persuaded by the reservations about my report expressed in the response of the Permanent Secretary of DWP. As DWP knows from my responses to their submissions, in my view some of the detailed points set out in annex D to this report are misconceived. Others have been dealt with already elsewhere in this report. What follows is restricted to an assessment of what I consider are the key submissions made by DWP that have some relevance to my findings and recommendations.

Content of official information

7.26. In relation to whether the evidence set out in my report justifies a finding of maladministration in relation to the content of official information, I should first state quite clearly that Parliament has decided that it is my role – and not that of any party to a complaint – to determine what constitutes maladministration.

7.27. I also note that DWP in its response did not question the six conclusions I draw at the beginning of my findings about the evidence set out in some considerable detail in chapter 4 of my report. Nor has DWP contested the factual description of the contents of the official information to which I have had regard – or the policy and guidance frameworks within which DWP and its predecessor placed their own actions at the relevant time.

7.28. The Government has therefore not questioned the factual basis on which my finding that official information was deficient rests. While it may not agree with my approach, the Government has given no reasoned argument as
to why I should not assess DWP’s action in accordance with the standards it set itself at the relevant time. Nor have I seen anything in its response to persuade me that my approach to assessing whether the content of official information constituted maladministration is either unsound or unreasonable.

‘Greater protection’

7.29. Turning to each specific submission on the content of official information made by DWP, I agree that Ministers have over many years said that the MFR was intended to provide ‘greater’ protection than the regime that was in existence prior to the commencement of the Pensions Act 1995. References to such statements are set out within my report.

7.30. However, I do not consider that such statements mean that the information provided by DWP and its predecessor did not constitute maladministration.

7.31. First, most of the public information leaflets to which my investigation has had regard do not contain such statements about ‘greater protection’.

7.32. Secondly, it seems to me that recognition that this was said on occasion does not remove the need for consideration of the rest of the official information provided in parallel to such statements.

7.33. In other words, if official information said that a particular provision – in this case, the MFR – was intended to provide a greater degree of protection, I would rightly be expected to have regard to the description from the same source of what that greater protection involved.

7.34. I consider that my report amply sets out the deficiencies in official information already. However, taking one example, official publicity issued in June 1996, at the time when the MFR was agreed, referred to the new regime as being one that would provide ‘greater protection’ but, in relation to the MFR, went on to say that ‘schemes funded to this minimum level will be able, in the event of an employer going out of business, to continue paying existing pensions and provide younger members with a fair value of their accrued rights which they can transfer to another scheme or to a personal pension’. That was not accurate.

7.35. Giving another example, leaflet PEC3, issued in January 1996, said, in response to a question ‘Why was the Pensions Act needed?’, that ‘the Government wanted to remove any worries people had about the safety of their occupational (company) pension following the Maxwell affair’. It then went on to provide assurance that a scheme funded to the MFR level would, regardless of what happened to the sponsoring employer, be able to continue to pay pensions in payment and provide non-pensioners with a cash value of their accrued rights. That also was not accurate.

7.36. Indeed, by the time this leaflet was issued, the Government had instructed the actuarial profession to devise a basis for the MFR that would only give non-pensioners an ‘even chance’ of replicating their pensions.

7.37. At no time until April 2004 did the DWP’s leaflets set out in clear and consistent terms what scheme members might expect from the protection afforded by being funded to the MFR level – even in answer to specific questions such as ‘how do I know my money is safe?’ and ‘what do I need to think about?’

7.38. In any case, I do not consider that general statements to the effect that the regime of which the MFR was a part was intended to provide ‘greater protection’ could be seen to be a clear and consistent statement that pension rights were at risk from scheme wind-up even if a scheme were fully funded to the MFR level.
7.39. I consider that this is even more apparent when those statements are considered together with the specific explanations that were provided in official information of what protection was provided where a scheme was funded to the MFR level.

7.40. Government bodies chose to supply information that purported to answer questions such as ‘how do I know my money is safe?’ and to provide information about ‘other things that could affect your pension’. It does not seem to me unreasonable that citizens would have had regard to such information. Nor does it seem unreasonable that they would have trusted that information. It came, after all, from a source with no apparent interest in promoting a particular pension choice, was said to be part of a wider financial education programme, and was produced by those responsible for the relevant statutory framework – and who therefore might reasonably be seen as best placed to know what the relevant legal provisions entailed.

7.41. It is therefore all the more surprising that such a key consideration was not mentioned in any of the official leaflets on these matters.

‘Health warnings’

7.46. In relation to the existence of ‘general health warnings’, it may indeed be the case that a statement that a particular leaflet was not a complete statement of the law and was for general guidance only might on occasion mean that it was understood that not all particular circumstances or possible scenarios were covered in that leaflet. This would be particularly true if a reader was seeking to gain a comprehensive understanding of the law or was seeking specific and tailored individual financial advice. In any case, in my view it is always preferable that such exclusions are set out explicitly.

7.47. However, where an official leaflet purports to answer the specific question ‘how do I know my money is safe?’, I do not think that such a ‘health warning’ can excuse the omission of perhaps the most significant factor in any reasonable answer to that question – that a pension was only as secure as the employer standing behind it.

7.48. As my report shows, that question – which DWP and its predecessor chose to pose – was never answered accurately. Only in April 2004 was its replacement – ‘is my money protected?’ – answered in broadly accurate terms, with information provided about scheme wind-up as a relevant factor.

7.49. A failure to cover scenarios that might only reasonably arise in extreme or highly unusual circumstances may be acceptable. However, a failure to mention the most highly material consideration in relation to a specific question...
that a leaflet posed would not meet DWP’s own standard, agreed on 11 September 2001, that there should be ‘no significant omissions’ in the information provided by the Department.

7.50. It is also because it is so far short of what has always been acceptable that I have concluded that it constitutes maladministration.

Accuracy of advice to join an occupational scheme
7.51. I do not doubt the statements in official leaflets that, for the majority of members who join a final salary occupational pension scheme, there are considerable benefits to doing so. Nor have I said in my report that such general advice was inaccurate.

7.52. What I have found is that, while there was a considerable degree of emphasis placed in official leaflets as to the benefits of joining such a scheme, there was inadequate disclosure of the risks.

7.53. I have accepted that there was no obligation on DWP and its predecessor to provide information about occupational pension schemes. However, as my report sets out, it has long been accepted – not least by DWP itself – that where public bodies choose to provide such information there are concomitant obligations on them to ensure that the information they produce is complete and accurate.

7.54. That did not happen in relation to the official leaflets covered by my investigation.

Role of official information
7.55. Turning now to DWP’s submissions as to whether official information was actually read by complainants and, if so, whether it would have prompted complainants to take remedial action or otherwise have materially influenced their actions, again I am not persuaded by their submissions.

7.56. First, while it is true that only approximately one-half of those complainants who responded to my survey can now demonstrate that they had seen the official information that I consider to be deficient, I think that it cannot be forgotten that a considerable time has passed since many of the leaflets were issued and read. Nor is it the case that all of those who cannot now demonstrate it did not see such information in the past.

7.57. I do not consider that it is reasonable to expect all individuals to now provide evidence in the form of copies of leaflets that were read many years ago. Such an expectation does not accord with the approach that my Office has taken in previous similar cases – nor is it one that DWP accepted in those cases.

7.58. Secondly, I do not accept that my report is deficient because it ‘offers no substantial evidence’ that, even where individuals had read the official leaflets that I have found were misleading, those individuals acted differently from how they otherwise would have acted.

7.59. In my view the submission that, had different information been provided, it would have had no effect on complainants is incompatible with other submissions made by DWP that, had their information leaflets dealt with risk, this might have ‘intimidated’ scheme members to leave the scheme to their likely detriment should their scheme not eventually wind-up. Nor is such a submission consistent with evidence set out in DWP’s own research among scheme members, which was undertaken in 2002 and published in February 2003.

7.60. The official information provided – whatever it said – either was a proper source of information to which citizens could reasonably have regard, or it was not – which begs the question as to why it was produced at all.
7.61. I note that the National Audit Office has recently said that ‘citizens should be able to rely on the accuracy and completeness of information provided by all government departments’ and that ‘written communication (in particular leaflets, letters and paid-for advertising) is regarded by the public as the most trustworthy source of information from Government’.

7.62. The case of complainants is that they read or had regard to official assurances that, so long as their schemes were funded to the MFR level, they could expect that pensions would be paid in full and that non-pensioners would receive a cash transfer of their full pension rights as calculated by an actuary.

7.63. That being so, and being reassured that this was the case – a reassurance provided by the public body responsible for the system of regulation over their pension provision and for the relevant provisions of the law – complainants took no action to diversify the risk to their pensions or to take any remedial action that was possible in the particular circumstances of their scheme.

7.64. Thus, what would have to be proved by complainants is a negative – that they did nothing because of the contents of official leaflets. Seeking to prove a negative such as this is notoriously difficult and does not seem to me to be a reasonable way to proceed.

7.65. When assessing what might have happened had maladministration not occurred, it is often the case that I will need to assess conflicting assertions. When considering such assertions, I will normally proceed on the basis of a balance of probabilities assessment, as it is often impossible to demonstrate conclusively which assertion – by a body under investigation or by a complainant – is correct.

7.66. Having had regard to all the circumstances, I consider that it is highly probable that any reasonable individual would have acted differently had they known the true position about the risks to their pension rights – for example, by making different choices about additional contributions, or by considering and taking the other actions I discuss in this report.

The 2002 MFR decision
7.67. I will now set out my assessment of the submissions of DWP and the Government Actuary related to the decision in March 2002 to amend the MFR basis.

7.68. It seems to me that these rest on the following three propositions:

(i) that the actuarial profession recommended the 2002 change to the MFR basis and the Government’s decision to implement it was wholly consistent with ensuring that the MFR was aligned to the original policy intention;

(ii) that the profession’s recommendation was supplemented by advice from GAD, which further reinforced the reasonableness of a decision to implement it; and

(iii) that the effects of the decision were in any case not significant.

7.69. I will consider each of these propositions in turn.

The profession’s recommendation and alignment with the policy intention
7.70. I have accepted that it was the case that the actuarial profession recommended the change to DWP – and I have not said that such a recommendation was unexpected by DWP or unwelcome among those who responded to consultations on such matters.
7.71. It should be remembered, however, that the MFR consultation had been published without reference to the actuarial profession’s recommendations of 5 September 2001.

7.72. The actuarial profession had subsequently informed its members that it had made those recommendations, but no other publicity at that time had been given to their specific recommendations regarding the MFR basis. Many individual actuaries responded to the MFR consultation – largely on behalf of scheme administrators or trustees. Some seemingly combined their response to the matters covered by the MFR consultation – which were in the public domain – with comments on the actuarial profession’s September 2001 proposals to amend the MFR basis – which were not yet in the public domain.

7.73. Thus, any responses received by DWP setting out views on the actuarial profession’s September 2001 recommendations to amend the MFR basis would have been received within a context in which many of those most affected by the MFR – such as scheme members – did not have an equal opportunity to comment on those recommendations.

7.74. Turning to the other submissions made by the Government, it may well be that the actuarial profession’s September 2001 recommendation was thoroughly discussed within the profession and that the profession had evidence which supported its analysis. Such evidence, however, was not provided to DWP at the relevant time.

7.75. Nor do I question that the Government had instructed the profession to devise a basis for the MFR that would provide only a certain degree of security for scheme members – and that it had asked the profession thereafter to monitor the economic and demographic contexts to ensure that the MFR maintained that original intended level of security. It seems to me that the profession undertook those responsibilities entirely properly within the remit that Government had set.

7.76. However, for the reasons I have already given I am not persuaded that the reasons for DWP’s decision can be explained by the fact that the profession had made a recommendation and that that recommendation aimed to realign the MFR with the Government’s original policy intention.

7.77. My investigation has shown that it was not the case that DWP generally or consistently implemented the recommendations of the actuarial profession in relation to the MFR basis.

7.78. In fact, the actuarial profession had made four sets of recommendations concerning the actuarial basis of the MFR and only two of them had been implemented.

**GAD’s advice**

7.79. Similarly, I accept that GAD gave advice to DWP and I also accept that GAD had access to the discussions within the actuarial profession about the MFR and other issues.

7.80. As is made clear in my discussion of this head of complaint, my focus has been on the decision-making process within DWP – and not on assessing the soundness of the professional advice provided to DWP.

7.81. My concern about this particular decision relates to whether DWP could be satisfied, as a reasonable decision-maker acting without maladministration, that the evidence base it could document and had verified was sufficient to enable it to make the decision it did in March 2002.

7.82. Given what I have said about the apparent mismatch between the approach taken to the decision on this particular recommendation and
that used in relation to deciding whether to implement other similar recommendations from the actuarial profession, it seems to me all the more important that a fully documented evidence base was in place.

7.83. Both DWP and the Government Actuary disagree with my interpretation of the scope of the advice provided by GAD to DWP in September 2001. I note also DWP’s suggestion that too much is being read into the precise wording of that advice.

7.84. However, that the scope and content of such important advice is open to interpretation at all – not on its merits or substance, but on what it purported to encompass – is a matter of concern. That is especially so if the email in question is the only documented record of advice regarding a proposed change to the mechanism that, to use the words of the Minister who piloted the legislation that created it through Parliament, ‘[underpinned] the employer’s pension promise’.

7.85. Finally, much has been made of alignment with an original policy intention. It should not be forgotten that that intention had never been disclosed to the public. Nor should it be forgotten that the decision to amend the MFR in 2002 was taken after DWP had been informed in clear terms that scheme members had no idea of the degree of protection that it was intended should be afforded by the MFR.

7.86. Official statements made at the time that the decision to amend the MFR basis was taken in March 2002, which referred to the change as being one which aligned the MFR with the Government’s policy intention, were of no practical use to scheme members. They were at that time labouring under the misapprehension – promoted by official information – that being funded to the MFR level meant that their pensions were secure.

Significance of change to MFR basis

7.87. It should be clear from the above that my findings do not relate to the effects of the 2002 change to the MFR basis but rather to the way in which the decision to effect that change was taken.

7.88. However, for completeness, I should say that I do not accept the submissions of the Government Actuary on the question of whether the 2002 MFR change – or indeed any other such change – was not material or significant when considering the complaints I have investigated.

7.89. Such decisions involved the level of assets that a scheme had to hold (or bring its funding level up to over time) to meet the MFR ‘test’ – and also the amount of money that a scheme on wind-up could legally reclaim from the sponsoring employer. The level of the MFR also was key in setting cash equivalent transfer values for members leaving the scheme and also for setting compensation where that was due.

7.90. It seems to me that the exact funding level at which a scheme operated – and to which it could, on wind-up, realise its assets in order to discharge its liabilities – is highly significant.

7.91. In addition, the Government Actuary’s submission that a change of around 3% to the MFR strength was not significant runs counter to another made by DWP. The Permanent Secretary of DWP told me that, according to complainants:

...it was thought that, if a scheme was funded up to the MFR, any accrued rights were safe.

Even if we accepted this proposition, which... we do not, it must follow that members of schemes which were not funded to the level of the MFR could not have had such an expectation and, therefore, that their losses cannot be attributed to any alleged maladministration...
By definition, a scheme that was not funded up to the MFR could not have been thought by its members to have satisfied this requirement, whatever protection they may have thought this offered.

...we simply do not regard as remotely plausible the argument [set out in annex C to this report] that a member of a scheme under-funded against the MFR could have drawn the inference that, if the MFR offered full protection, those who were not funded up to the MFR could expect proportionate protection.

7.92. I should explain that I am not persuaded by DWP’s view of whether it was reasonable for scheme members to assume ‘proportionate protection’. Such a view would seem to be contrary to the statement by the then Secretary of State in the December 1994 ‘Butterfill letter’ that the statutory requirement would ‘provide an important, objective measure of the adequacy of a pension fund; something which members and trustees will be able to monitor and against which the performance of the fund... can be measured’. It would also seem inconsistent with the Government’s contemporaneous description of the MFR as a ‘benchmark’.

7.93. Nevertheless, it appears that the Government’s current position is that being 100% funded on the MFR basis invoked the protection, however limited, that was provided by coverage to that level — but that members of those schemes that were less than 100% funded could not expect ‘proportionate’ protection. A Ministerial answer given in July 2003 said that the effects of the 2002 decision to amend the MFR basis may have weakened the MFR test ‘by around 3 per cent’. My advisers suggest that the figure may be somewhat higher.

7.94. In my view, it does not matter which assessment is correct. If what I have described above is indeed the Government’s position, then even a very small percentage point shift in the strength of the MFR would have had very serious implications indeed for schemes broadly funded around the MFR level. Weakening the MFR test would have increased the protection given to the non-pensioner members of schemes just below 100% on the MFR basis — as a scheme funded at, say, 99% on the MFR level (whose members would not, according to the Government’s account, have been protected) would become more than 100% funded, with the resulting extension of protection — and strengthening the test would have had the opposite effect.

7.95. In addition, as it appears that many sponsoring employers only funded to the minimum level, such shifts might therefore have had a very widespread effect.

7.96. Leaving aside the question of whether such important facts should have been disclosed by Government, it seems to me that the MFR — and therefore any change to its basis — was the core of a very central concern for all members of those final salary occupational pension schemes that were covered by it — namely, the security of their pensions.

7.97. As was recognised in the Myners report that was commissioned by Government and published in March 2001, one of the failings of the MFR system was that it was ‘treated as a technical question, for resolution by the actuarial profession’. Such an approach, it was said, was not justified — as the MFR basis was ‘not an obscure technical question, but the very heart of the question of whether the fund is adequately funded or not’.

7.98. Given the nature of the complaints I have investigated, any changes to the MFR basis seem to me to have been both material and significant.
Causality

7.99. Turning now to issues of causality, again I am not persuaded by the submissions made by DWP.

7.100. First, I have not said in this report that financial losses were caused by deficiencies in official information alone. I have found that such maladministration played a role – with other factors – in creating the conditions in which such losses were sustained. That role was to provide false assurance to the extent that no reasonable person reading that information would realise that, in certain circumstances, they needed to consider and/or take action both to seek to remedy scheme funding shortfalls or to otherwise protect their own position. I have also found that financial injustice was a consequence of the maladministration I have identified, as scheme members were unaware that their pensions were only as secure as their employer due to deficient and misleading official information.

7.101. I am recommending that Government consider whether it should take the lead in remedying the injustice identified in this report. I do so because I have found that maladministration was a significant contributory factor to that injustice and because it seems to me that Government is best placed to do so.

7.102. Secondly, it appears that DWP is suggesting that any recommendations I make to remedy the injustice that is a consequence of the maladministration I have identified must be related to each individual complainant – and must be based on those individuals each separately demonstrating beyond reasonable doubt many years later:

- first, that they had read official information;
- secondly, which information they had read and exactly when; and
- thirdly, what effect reading that information had had on them.

7.103. It seems to me that this approach, were I to accept it, would in an unreasonable manner reverse the burden of proof in situations where I have found that maladministration had occurred. In such situations, I look to those responsible for the maladministration I have identified to satisfy me that the relevant shortcomings in their actions have not caused or contributed to the injustice claimed by those individuals affected by those actions.

7.104. The Government’s current approach would also be inconsistent with the approach that my predecessor and DWP have taken in relation to cases which involve deficiencies in widely available public information leaflets in the past – such as in relation to my Office’s inherited SERPS investigation.

7.105. In that case, my predecessor’s view, as reported in paragraph 32 of his report ‘State earnings-related pension scheme inheritance provisions’, which was published on 15 March 2000, was that:

...individuals who claim to have been misled or misdirected by information given by a department are normally expected to provide some evidence that they have been misled into acting, or failing to act, in a way that has been to their disadvantage. Only then is compensation considered.

However, I questioned whether that approach was tenable in the circumstances of the complaints being referred to me. As I saw it, anyone who had read the relevant DSS leaflets might reasonably claim to have been misled by them.

Whatever such a person then did or did not do, it seemed to me that the burden of proof that he or
she would not have acted differently had he or she not been misinformed rested on the department.

I therefore considered that, whatever the approach the department decided upon in order to make good the effects of their maladministration, it would need to be capable of providing due redress on a global, rather than an individual, basis. I also felt that any evidential hurdles pertaining to eligibility for compensation should have regard to the principles concerning the burden of proof which I had set out.

7.106. The Government accepted this approach at the time and also accepted that the burden of proof lay with them. In a statement to the House on the day that my predecessor’s report was published, the then Secretary of State for Social Security said:

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.

7.107. Moreover, the Government accepted that redress was not to be limited to those who could themselves prove that they had definitely made alternative choices. As the then Secretary of State continued to say in the same statement (with emphasis added):

...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.

7.108. After announcing the creation of a new designated pensions agency, which became today’s Pensions Service, the then Secretary of State concluded his statement by saying:

We also have a responsibility to provide clear information to the public... The public rely on government information. They are entitled to be reassured that leaflets are accurate and comprehensive... In future, DSS leaflets will be subject to external audit, so that people can rely on clear and accurate information.

7.109. I see no reason to depart from the approach adopted by my predecessor and accepted by the Government at the time.

7.110. In both the inherited SERPS case and in this investigation, the maladministration identified was the omission of significant considerations from the information that the Government said was included in official leaflets. In both cases the leaflets in question contained ‘health warnings’ and were said to be of a general nature that, in their own right, would not be a sufficient basis on which individuals could make important financial decisions.

7.111. In both cases, a financial loss was not caused by that deficient information – with inherited SERPS, the losses were caused by changes to entitlement which had been enacted by Parliament some years previously – but rather in both cases the people affected had had no idea until too late that they might suffer such a loss due to the distorted reality that resulted from the deficient and misleading information in official leaflets.

7.112. In the end, with inherited SERPS, the Government decided to devise a ‘global’ solution to the problem due to the practical problems in devising and administering an ‘individual’ redress scheme where the burden of proof lay on the Department. It may be that similar practical obstacles exist in this case.

7.113. Nevertheless, it seems to me that there is a public interest in asking those whom I have found were responsible for the
maladministration I have identified in this case to seek to develop a solution to the losses sustained by those who have had their expected pensions taken away through no fault of their own.

7.114. If an ‘individual’ approach is taken, it also seems reasonable to me that the burden of proof when determining whether or not individuals read the deficient leaflets and acted – or refrained from action – as a result should be on those who placed misleading information in the public domain.

Further response from Government

7.115. In the light of my assessment of their response to my findings which is set out above, I asked DWP for the Government’s final response to my findings.

7.116. DWP provided a further response on behalf of the Government on 28 February 2006. I have reproduced this response in the words of its Permanent Secretary, below.

The Department wishes to make clear at the outset that it has the utmost sympathy with those individuals whose pension schemes have been wound up and who have, as a consequence, lost a significant part of the occupational pension they had been led to expect by their scheme.

That cannot mean, however, that the Department is responsible for the losses. It is clear that the responsibility for such losses must fall fundamentally to the companies whose schemes were wound up and the trustees who, with the benefit of professional advice, were responsible for ensuring their scheme was funded to a level compatible with their liabilities and the strength of the employer’s commitment to his scheme. All of the issues covered in this report have, in the Government’s view, to be seen within this fundamental context.

As regards the decision to change the MFR in 2002, the Department’s view is that it acted wholly responsibly in implementing the recommendations of the actuarial profession which had received the full backing of the Government’s own professional advisers in the Government Actuary’s Department. The Department’s view is that that is precisely what would have been expected of any responsible Department acting reasonably in an area of acknowledged complexity. In the Department’s view, it would have been far more vulnerable to justified criticism had it substituted an alternative judgement in the face of clear and consistent advice from the actuarial profession and from GAD without good reason.

There were good reasons for not implementing the recommendations made by the actuarial profession in 2000 and 2003. Both of those recommendations involved more complex changes which would have required long administration lead-in times. In both cases the MFR was expected to have been abolished by the time the changes would have had much, if any practical effect.

As regards the issue of alleged misinformation in various speeches, statements and leaflets, the Department – for the reasons set out before – holds strongly to the view that the information put forward was, and was only ever intended to be, of a general nature and carried numerous disclaimers and health warnings making clear that it could not be relied upon by any individual, or their adviser, in reaching detailed decisions about their own best course of action.

Even more importantly, however, leaving aside the issue of whether individual statements in individual leaflets or communications might or might not have been differently worded, the Department takes the view that the primary responsibility for ensuring that individual
members of pension schemes were not misled as to the viability and security of those schemes rested fundamentally and clearly with the trustees of those schemes, supported by their professional advisers.

In that context, there is no doubt whatsoever that, whatever misconceptions may have been held by individual scheme members as to the degree of assurance afforded by the MFR, professional advisers to pension schemes were clear from the outset as to the true position. In this connection we believe that the report fails to consider adequately whether individual scheme members received, or should have received, information from their scheme’s trustees (informed as this would have been by advice they received from actuaries or other professional advisers).

The report attaches great significance to the reassurance which scheme members might have gained from funding to the MFR level. We believe that the report pays insufficient regard to the fact that very few schemes involved in this investigation were actually funded to the MFR level when they wound up.

Finally, the Department takes the view that, even if all of the foregoing did not apply, the report has failed to establish the necessary degree of causality between the information by the Department and the decisions taken by individuals. Put at its simplest, the Department believes that the report fails to demonstrates that the decisions which individual complainants took, or did not take, were directly influenced by the information which the Government did or did not make available.

In conclusion, the Department, while reiterating its sympathy and understanding of the distress caused to individuals by the failure of their pension schemes to deliver the benefits to which they believed they were entitled, reiterates its view that this report does not establish any sound basis on which the Government can, or should, accept liability on behalf of taxpayers as a whole for these events.

7.117. The Permanent Secretary told me that, accordingly, the Government was minded to reject the first four of my recommendations but to accept the fifth. He also told me that, while he was grateful for my offer that they should have two months from publication of my report in which to consider and respond to my recommendations, ’we consider that such an extension is unnecessary and, given the potential for raising false hopes, undesirable’. DWP told me that, while the Government was minded not to accept my findings or recommendations, it would only provide its final response to my report after it was published.

My response to the Government’s position
7.118. The Government says that DWP is not responsible for the losses suffered by scheme members and that responsibility lies with the companies whose schemes were wound up and with the scheme trustees who, acting with the benefit of professional advice, were responsible for safeguarding the interests of scheme members.

7.119. For the reasons I have already set out in chapter 5 of the report, I have found that maladministration was a significant contributory factor in the creation of financial loss and that it also caused injustice of other kinds. Nothing in DWP’s submissions persuades me otherwise.

7.120. The Government says that the information it provided was only intended to be of a general nature and carried disclaimers and ‘health warnings’, so it should not have been relied upon by individuals, or their advisers, in reaching decisions about their own best course of action.
7.121. For the reasons I have already set out in chapter 5 of the report, I have found that the information provided by DWP did not meet the standards that it set for itself and, being incomplete, unclear, inconsistent and often inaccurate, that it was so far short of what is acceptable administrative practice that it constituted maladministration. Nothing in DWP’s submissions persuades me otherwise.

7.122. The Government says that my report fails to demonstrate that decisions taken by individual scheme members were directly influenced by Government information.

7.123. Chapter 2 of my report shows that complainants told me that this was the case – and many of them provided examples of the leaflets on which they relied. I have found no reason to doubt what those people told me. In making this response, the Government appears to question both the credibility of the people who have complained to me and my judgement in assessing their credibility. Nothing in DWP’s submissions persuades me that my judgement was unsound or unreasonable.

7.124. The Government says that my report places insufficient emphasis on the role that trustees and their advisers might have played among the causes of financial loss to scheme members as a result of their investment decisions or through not properly informing members of risk.

7.125. I have recognised in chapter 5 of the report that trustees were an integral part of the system and context in which those losses were sustained. It is not for me to investigate the actions of the trustees of each scheme covered by the report.

7.126. Where trustees have acted unlawfully, an alternative remedy exists for any losses caused as a result. I also note, in respect of the actions of trustees that are not unlawful, that, during the relevant period, official statements made or published by the bodies I have investigated suggested that it was the employer alone who bore any risk associated with investment decisions in final salary schemes.

7.127. In addition, what trustees had to tell scheme members was prescribed in laws developed by Government and approved by Parliament. I see nothing in DWP’s submissions that makes me consider that my report is deficient in the way it suggests.

7.128. The Government says that, in March 2002, it acted wholly responsibly in implementing the clear and consistent recommendations of the actuarial profession, which were backed by GAD. The Government also says that, had it not implemented those recommendations without good reason, DWP would have been subject to serious criticism – and that there were good reasons for not implementing other recommendations made in 2000 and 2003, as they were complex and as the MFR was due to be abolished and thus there would be little time for those changes to have had any effect.

7.129. For the reasons I have already given in chapter 5 and above, I have found that the way in which DWP took its decision in 2002 to weaken the MFR basis constituted maladministration. I am not persuaded by the reasoning provided by DWP to explain why it decided to weaken the MFR basis in 2002 but decided, on two occasions, not to strengthen it.

7.130. The complexity of one recommendation can hardly be a reasonable explanation of such decisions when Government acknowledges that the MFR was by necessity always complex and technical.

7.131. Neither can the short time before the expected abolition of the MFR account for DWP’s decision as, if it was a factor in the
decision in 2000 not to strengthen the MFR, it was all the more relevant in March 2002, by which time that abolition was closer and there was less time for the change to have any effect.

7.132. Nor can the risk of serious criticism explain the inconsistency with which DWP approached the matter of the strength of the MFR basis. If DWP had to implement the 2002 change to the MFR to avoid such criticism, I fail to see why that factor did not also mean that the 2000 and 2003 recommendations to strengthen it were not also implemented.

7.133. DWP says that very few schemes to which the people who have complained to me belonged were ever funded to the MFR level or were so when they wound up.

7.134. I have already provided my assessment of this submission in annex C to the report. Nothing in DWP’s submissions persuades me that my assessment is unsound or unreasonable.

7.135. The Government says that there is no sound basis on which the Government should accept liability on behalf of taxpayers as a whole for the events relevant to my investigation.

7.136. As I have already explained above, that is not what I have suggested. Nothing in DWP’s submissions persuades me that my conclusions that maladministration played a significant role in causing injustice to individuals or that Government is best placed to take the lead in developing a solution to remedy that injustice are unsound or unreasonable.

7.137. I have carefully considered all of the submissions made by DWP on behalf of the Government in response to my report. Having done so, I remain wholly unpersuaded by those submissions.

7.138. The Government has told me that it intends to provide its ‘final response’ to my report following publication. At the time of publication, the Government has not accepted my findings and has told me that it is minded not to comply with all of my recommendations. Therefore, there is no basis on which I can be satisfied that the injustice I have identified will be remedied.

7.139. I am therefore laying this report before both Houses of Parliament pursuant to section 10(3) of the Parliamentary Commissioner Act 1967 to denote that I have found injustice in consequence of maladministration which the Government does not propose to remedy.
8.1. The subject matter of this report is one that is linked to many of the current debates within public policy. The wind-up of occupational pension schemes – and the losses that have occurred as a result of many of those wind-ups – also touches on a number of critical issues at the heart of public administration and on the relationship between citizens and those who govern them.

8.2. On the one hand, it has long been stressed – and recent evidence from a range of sources has re-emphasised this – that savings and pension decisions are critical decisions on which the future, long-term security of individuals and their families depend. Much concern has been expressed about ‘savings gaps’ – and about the inadequacy of reliance both on state retirement provision alone and on the insufficient additional pension provision that citizens are acquiring for themselves.

8.3. On the other, it has also been a matter of consensus for some time that one of the key disincentives to individuals acquiring pension cover additional to that provided by the State has been a lack of trust that investment in a private pension is a secure and worthwhile means of providing for the financial future of individuals and their families.

8.4. It has often been said that pensions is a partnership between the individual, the State, and the pensions industry. Where private pensions are provided through membership of an occupational pension scheme, that partnership also extends to the employer who sponsors such a scheme.

8.5. Individuals have clear interests in securing their future through planning ahead for their retirement. Employers often see the provision of good pension arrangements as a means of attracting and retaining high quality staff. The pensions industry provides the means to do all this. It seems to me that, as a partner in this system, the State also has incentives to ensure secure and adequate retirement provision for all those who can afford to make such provision – not least as such provision reduces reliance on means-tested support for pensioners.

8.6. The events which have formed the focus of this investigation are naturally distressing for those whose financial security has been so profoundly affected by the loss of part or all of the pensions they had been promised when they decided to make additional provision for their retirement and for their family’s security.

8.7. However, it seems to me that these events should concern us all – as they go to the heart of the – perhaps unwritten if not unspoken – contract between the various parts of the pensions partnership. They also relate in a most fundamental way to such key considerations as the role of the State, the purposes of regulation and of the information provided by public bodies, and the bond of trust between the citizen and Government.

8.8. In considering the evidence I have reviewed in this investigation, I have been struck by a number of mismatches – but also by a degree of continuity.

8.9. It will be obvious to readers of this report that I have found that there was a clear mismatch between the level of security that final salary occupational scheme members could expect from the legal, regulatory and administrative frameworks in place and the information that was put into the public domain about such protection.

8.10. Nobody doubts that pensions – and pension scheme funding – is a technical and complex subject. But if citizens are to be empowered to make informed choices about savings and pensions options, which is an...
admirable and necessary objective, then those who devise, administer, and enforce the rules and frameworks within which those choices will inevitably be made should be as clear as possible about what citizens can expect from others and about what their own responsibilities are.

8.11. It seems to me that clear, complete, accurate and consistent information, tailored where appropriate to different levels of knowledge and experience, is a necessary part of creating an environment in which informed choice can flourish.

8.12. Another mismatch that emerges from the evidence set out in this report relates to the role of Government in the private pensions world and, in particular, to its own perception of that role.

8.13. Considering the evidence I have examined in conducting this investigation, it seems to me that insufficient regard was had by such public bodies over many years to the influence that they – and the information they provided – would have on those who were seeking to make choices about private pension provision.

8.14. While I understand why Government might now consider that its role within this context was limited and its view that others – particularly individual citizens – should have always recognised that this was the case, this was not what they said at the time. Nor do I have any doubt that information provided by Government was widely seen as being authoritative and persuasive.

8.15. Readers of this report will also know that I consider that such a view was a reasonable one for citizens to hold. After all, if those who created laws to provide protection for pension rights and to define and determine the responsibilities and rights of the various parts of the pensions ‘maze’ could not be relied on to set out that protection and those responsibilities and rights clearly, then who could?

8.16. I believe that it is a proper public function for Government to seek to identify the need for adequate retirement provision and to inform people clearly of the options they have. It also seems entirely proper that public bodies should oversee frameworks of regulation and control that support pension provision of all types, to ensure that investment in pensions is undertaken in a reasonably secure environment.

8.17. However, I consider that many of the problems I have identified in this report are related to insufficient clarity about what Government’s role was during the relevant period in relation to the framework of final salary occupational pension scheme funding. It is one thing to set standards or to provide safety nets. It is another to prescribe in great detail the level at which each scheme should be funded.

8.18. It seems to me, when Government did the latter, that it was hardly surprising that complaints were directed towards those public bodies which designed and oversaw the funding framework when that prescribed level proved inadequate – or rather, when it failed to provide the protection that scheme members had been told it would provide. Nor does it seem that such an eventuality would have been a surprise to Government – after all, a GAD actuary had told them in June 1999 that he was ‘waiting for the edifice to collapse’ and for complaints about these matters to be made.

8.19. This brings me to some continuities.

8.20. The events I have investigated took place within a statutory and regulatory framework which has now been replaced. I hope that the pension protection arrangements that form part of this new regime are being properly explained to scheme members and others in clear and
consistent terms. As a recent NAO report shows, ensuring that the information provided to the public is accurate and complete while being accessible remains a challenge for DWP.

8.21. Despite the very different nature of the new regime, many issues relevant to the old regime continue to be of central importance to those operating the new arrangements – and to the other members of the pensions partnership.

8.22. Such continuities include the desire to balance the interests of sponsoring employers and those of scheme members, the desire to ensure that pension rights are afforded a reasonable degree of security while not imposing so stringent a burden that there is a sustained and irreversible retreat from occupational pension provision, and the desire to promote opportunity and real choices for those seeking to secure their financial future.

8.23. However, there is perhaps one other continuity that is of direct relevance to the subject matter of my report.

8.24. The then Secretary of State for Work and Pensions said in the House of Commons on 2 March 2004, when moving the Second Reading of the Pensions Bill which contained provisions to replace the old regime, that ‘I am clear that a pensions promise made should be a pensions promise honoured’.

8.25. Concluding that debate, the then Pensions Minister said:

When we vote this evening, the House has an opportunity to take the first steps to make the Pensions Protection Fund a reality, a major social policy innovation, a consistent piece of pensions architecture – to build confidence that a pension promise made will indeed be a pension promise honoured.

8.26. Yet this aspiration was nothing new. The then Secretary of State for Social Security in the previous Government said in a debate in the Commons on 3 November 1993 on the proposals of the Goode Committee – which, as is noted in chapter 4 of this report, were the foundation on which the Pensions Act 1995 was built – that:

Professor Goode spelled out his intention when he said that he wanted to make a reality of the pensions promise. We want to make sure that the promise inherent in membership of a pension fund is fulfilled – that its assets are there to ensure it is fulfilled and properly funded, and that abuses do not occur.

8.27. A Minister in that Government later said that the MFR had been designed to underpin the employer’s pension promise.

8.28. Governments have never said that fraud or abuse can be totally prevented. Indeed, the 1995 Act was very much a response to the Maxwell affair. However, as is also noted in chapter 4 of this report, the then Government urged support for the introduction of the MFR in clear terms:

After everything that has happened in the past few years... we could not be proud... if we were not in the end able to say that schemes must have sufficient assets available within a certain time to keep pensions in payment and give non-pensioners the value of their accrued rights... That is the least that we should require of schemes.

Without that requirement, what on earth would we say to people who ask whether their pension funds will be able to keep their pensions in payment or give them the value of their accrued rights if the scheme winds up?

Without the MFR, the answer to such a question would be no. What on earth would we have achieved then? The Minimum Funding Requirement would mean that the answer would be yes. That is all we seek with the MFR.
8.29. Those who have complained to me asked that question. Having been assured by official information for many years that their pensions were safe if their scheme was funded in accordance with the MFR, they now look to those who provided this assurance – which they trusted – to honour the pensions promise that has been broken.

8.30. This Government is, in the words of a Minister on 3 April 2000, 'aware of the importance of protecting members’ rights. That is the bottom line. If we cannot do that, they have no-one else to look to.'
Annex A
The context

Introduction
1. This annex describes in broad terms the system of pension provision in the UK and some key aspects of the statutory framework that governed final salary occupational pensions in the relevant period.

2. Before doing so, I should explain that many of the provisions I go on to describe have been replaced since the commencement of the new regime governing private pension provision in April 2005. Other aspects remain in force. In this annex, I generally use the past tense throughout. This is in recognition that the events relevant to this investigation took place from 24 January 1995 to 6 April 2005.

Pension provision in the UK
3. One way of describing the system of pension provision within the UK is to categorise pension provision according to the different sources of the various elements of possible retirement income and how these sources interact with each other.

4. Using this approach, we might say that there were five principal categories of pension provision in the UK:
   (i) state retirement pensions;
   (ii) retirement annuity contracts – which have ceased to be entered into since July 1988;
   (iii) personal pension plans (from July 1988 onwards) and stakeholder pensions (from April 2001 onwards);
   (iv) public sector occupational pension schemes, including those for current members (and veterans) of the armed forces; and
   (v) private sector occupational pensions.

5. Before setting out both the main features of the occupational schemes relevant to this investigation and how the contracting-out provisions affected pensions provided by such schemes, I will summarise the main features of state pension provision insofar as these were relevant to the matters I have investigated.

State retirement pensions
6. A state pension is payable to all individuals who have reached state pensionable age, who have made or been credited with (or whose spouse has made or been credited with) sufficient national insurance contributions, and who have made a claim for a state pension.

7. There are four principal categories of state retirement pension:
   (i) a Category A retirement pension – which is payable to someone who reaches the relevant state retirement age and who has in their own right made or been credited with sufficient national insurance contributions to qualify for the basic state pension;
(ii) a Category B retirement pension – which is payable to someone who reaches the relevant state retirement age and whose spouse has made or been credited with sufficient national insurance contributions to enable their spouse to qualify for the basic state pension;

(iii) a Category C retirement pension – which is payable to those people who were already over pensionable age on 5 July 1948, regardless of their contribution record; and

(iv) a Category D retirement pension – which is payable to people aged 80 or over, who either get no basic state pension or whose pension is below a given amount and who have lived in the country for at least ten years after reaching age 60.

8. A state retirement pension payment may include one or more of the following elements, namely:

- the basic state pension – a flat rate payment at generic rates set for single people and, for each couple, a payment to reflect the total rate of Category A and B pensions;
- the additional state pension – an earnings related element with respect to an individual's specific earnings between April 1961 and April 1975 (graduated retirement benefit) and/or after April 1978 (the State Earnings Related Pension Scheme – SERPS – and, since 6 April 2002, the State Second Pension);
- increases for qualifying dependants or for invalidity;
- an age addition for those aged over 80;
- increments in respect of periods of deferred retirement, where the individual has elected not to take their state pension as soon as they were entitled to do so; or
- a Christmas bonus and/or winter fuel allowance.

9. Where an individual's national insurance contribution record falls short of the minimum qualification requirements, which are set out in legislation – or where an individual moves abroad to certain countries on retirement – a reduced or frozen state pension may be payable.

10. There are three classes of national insurance contributions which may qualify an individual for a state pension in his or her own right:

(i) class 1 contributions, of which there are two types:
- primary contributions, which are made by all employees whose earnings are in excess of a primary threshold and are paid on all of their earnings up to an upper earnings limit (both limits are set out in statute); and
- secondary contributions, which are payable by employers in respect of their employees whose earnings are in excess of a secondary threshold (there is no upper limit for secondary contributions);

(ii) class 2 contributions, which are flat rate contributions payable by the self-employed; and
class 3 contributions, which are voluntary contributions which may be made by an individual to boost their contribution record so as to ensure that he or she has made or been credited with sufficient contributions to qualify for a state retirement pension.

11. For class 1 contributions, individual employees pay additional national insurance contributions of 1% of their earnings above the upper earnings limit – towards the National Health Service.

12. In addition to the basic element of the state pension, which is dependent on national insurance contributions, there is, as noted above, a further, earnings-related component to the state pension, known as the additional pension.

13. The additional state pension over time has had three manifestations: graduated retirement benefit, SERPS, and the State Second Pension.

14. Graduated retirement benefit is payable as an increase in the weekly rate of state retirement pension and was introduced by the National Insurance Act 1959. It is now governed by the provisions of the National Insurance Act 1965, which remain in force in order to ensure payment of the benefit for those who had actual or prospective rights prior to 6 April 1975, from when this form of additional pension no longer accrued.

15. Through SERPS, an individual may qualify for an additional pension through contributions made in relation to earnings received in the period from April 1978 to April 2002, in respect of earnings for each year between the lower and upper earnings levels, as determined in law.

16. At retirement, once an individual’s earnings up to the upper limit for each year have been determined, they are increased in line with the rise in national average earnings (as set out in the relevant Revaluation of Earnings Factors Order, a statutory instrument made by the Secretary of State) to take account of inflation. Finally, an amount equal to the lower earnings limit in the last complete tax year before the one in which the individual attains state pension age is deducted to produce that individual’s surplus earnings for each tax year.

17. Prior to 6 April 1999, an individual reaching state pension age would qualify for an annual rate of additional pension which was calculated by multiplying the aggregate of his or her surplus earnings for all the years which counted for additional pension by 1.25%.

18. After 6 April 1999, the annual rate of SERPS that a person reaching state pension age would receive would consist of:

(i) the aggregate of their surplus earnings in the tax years from April 1978 to April 1988, multiplied by 25% and then divided by the total number of years between 6 April 1978 (or 6 April immediately preceding their 16th birthday, if later) and the 5 April immediately preceding their 65th birthday (or their 60th birthday, in relation to a woman); plus

(ii) the aggregate of their surplus earnings in the tax years from 6 April 1988 to the 5 April immediately preceding them attaining state pension age, which is multiplied by the relevant percentage (which varies between 20% and 25% depending on the year in which
they reach state pension age) and then divided by the total number of years between 6 April 1978 (or 6 April immediately preceding their 16th birthday, if later) and the 5 April immediately preceding their 65th birthday (or their 60th birthday, in relation to a woman).

19. From 6 April 2002, SERPS was reformed to provide a more generous additional state pension for low and moderate earners, and to extend access to include certain carers and people with a long-term illness or disability. The reformed additional state pension is known as the State Second Pension. The State Second Pension is based upon earnings between a lower earnings level and an upper earnings level.

20. Where a person is contracted-out of the additional state pension (see below), their entitlement to additional pension for the period during which they are contracted-out is reduced or removed to recognise the pension derived from contributions made to an occupational or personal pension scheme instead of towards the state scheme.

21. For earnings in the tax years from 1978/79 to 1996/97, a member of a contracted-out occupational pension scheme accrued additional state pension in the same way as someone who was not contracted-out, but the rate payable was reduced by a contracted-out deduction.

22. For earnings in the tax years from 1997/98 to 2001/02, a member of a contracted-out occupational pension scheme did not accrue additional state pension in respect of earnings in contracted-out employment.

23. For earnings in any tax year starting from 2002/03, a member of a contracted-out occupational pension scheme earning between £4,264 and £27,800 (in 2005/06 terms) in a tax year will get a State Second Pension top-up in respect of that year. The top-up reflects the more generous additional state pension provided by State Second Pension and is paid as part of the state pension.

**Occupational pensions**

24. During the relevant period, there were three types of occupational pension scheme:

(i) defined benefit schemes (also known as final salary schemes), which are the principal focus of this report;

(ii) money purchase or defined contribution schemes; and

(iii) mixed benefit schemes, which combine features of the above.

**Scheme governance and membership**

25. Pension schemes in the private sector were established by trust law. Schemes were governed by trustees, whose role it was to apply the scheme assets for the benefit of scheme members and other beneficiaries in accordance with the law and the scheme's trust documents.

26. Trustees were largely appointed by the employer or employers who sponsor the scheme, although since 1997 there has been a requirement (although certain schemes may in specified circumstances opt out of this) that each scheme has a number of member nominated trustees.
27. Sometimes an insolvency practitioner may be appointed in relation to the sponsoring employer of a scheme or the official receiver may become the liquidator of the relevant company or the manager of the estate of a bankrupt employer. In those circumstances, it was the duty of the insolvency practitioner or official receiver to satisfy themselves at all times that at least one of the trustees of the scheme was an independent person.

28. If that was not the case, an independent trustee had to be appointed, who could not have an interest in the assets of the employer or the scheme, who could not have been associated with the scheme in a professional capacity during the preceding three years, and who could not be connected with or be an associate of the employer, the insolvency practitioner or official receiver, or other persons with a direct interest in the scheme.

29. All trustees had a duty not to profit from their position as trustee and were obliged to act as a prudent person would, not only in their own conduct but also in relation to third parties. Trustees had to act in accordance with the trust deed and other rules and had to act impartially as between different classes of beneficiaries. Finally, trustees had to familiarise themselves with their investment powers and seek appropriate professional advice to enable them to apply the assets of the scheme in the best interests of its beneficiaries and to comply with the relevant legislation.

30. Trustees were obliged to disclose certain documents and information to scheme members, prospective members, other beneficiaries and to appropriate trades unions. Each scheme was also obliged to establish an internal dispute resolution mechanism.

31. Since 1988, membership of an occupational scheme could no longer be compulsory and any term of a contract of service purporting to make membership of a particular scheme compulsory was void unless it related to death-in-service benefits within a scheme which was non-contributory.

32. There were broadly four types of members of final salary pension schemes:

(i) active members – those who were working for the sponsoring employer and having contributions made on their behalf (and who may themselves be contributing) to the scheme;

(ii) pensioners – those who were receiving benefits from the scheme;

(iii) deferred members – those who had left the service of the sponsoring employer but who retained benefits in the scheme; and

(iv) other qualifying individuals – those in receipt of a survivor pension (for example, a widow) paid in respect of the benefits accrued by a deceased member.

Scheme funding and benefits

33. In defined benefit pension schemes, the trust deed and rules set out the basis on which benefits were paid. Typically these defined the amount of benefit and the circumstances under which it was paid.
34. The amount would normally be defined as a proportion of an individual’s salary (‘salary’ for this purpose was defined in the rules) and typically depended upon the length of service the employee had completed as a member of the scheme. Benefits were paid from an age laid down in the scheme rules. The rules also stated whether benefits were payable in other circumstances, for instance where a member left work on ill-health grounds.

35. If an individual left to take up employment elsewhere, the benefits would usually be calculated based on service and salary as at the date of leaving. The individual had the opportunity to leave the benefits in the scheme (i.e. to become a deferred member of the scheme) or to take a transfer value to another scheme.

36. In order to provide these benefits, the employer (and the employee, if required under the rules) made contributions. These contributions are said to ‘fund’ the benefits. Upon receipt of contributions, the trustees arranged for them to be invested. The invested contributions then became the ‘assets’ of the scheme.

37. The obligation to pay the benefits of a given amount and in the specified circumstances, became the scheme’s ‘liabilities’.

Setting contribution rates
38. The current value of a scheme’s liabilities was not generally known in advance with any certainty and in most schemes the employer picked up the balance of cost in terms of a variable rate of contributions to fund the liabilities. Members’ contributions were usually a fixed percentage of salary although in some schemes their contributions could vary too.

39. The trustees of a scheme were bound to follow the trust deed and rules and relevant legislation with regards to the funding of members’ benefits. The terms of schemes’ legal documentation varied widely but might have stated either that the sponsoring employer determined the rate of contributions to the scheme or that the trustees decided on this, after having taken advice from the scheme actuary, after consultation with the employer, and subject to the provisions of the MFR legislation.

40. The common reference to the MFR legislation was a reminder to the trustees that this was the legal minimum at which they must plan to fund the scheme. This would have been the default position in the absence of agreement to higher amounts.

41. In this situation, the employer had a duty, after consultation, to pay the contributions decided on by the trustees. Consultation between trustees and employers took place at various different levels. There were also schemes where the employer held more of the contribution setting powers.

42. In rare cases the scheme actuary may have had the power to set contributions. There may have been other constraints on the employer(s) contributions contained in the scheme documentation.
43. However, in all cases, shortly after an actuarial valuation had been carried out, the trustees and employer needed to jointly agree on a schedule of contributions which specified the contributions that the employer(s) and employees would pay in future.

44. The scheme actuary was a statutory role with responsibilities to carry out MFR valuations, generally every three years, on the prescribed basis and to certify that the contributions agreed between the trustees and employer would be sufficient to satisfy the MFR – that is, to remain above or restore the scheme to a 100% MFR funding level within prescribed time limits – for the period of the schedule of contributions.

45. Legislation also required ongoing valuations, generally every three years, and individual schemes’ documentation may have placed additional requirements on the actuary in terms of carrying out valuations and recommending rates of contributions.

46. The MFR only provided a minimum level at which schemes needed to aim to be funded. The range of contribution setting powers of different schemes, the interpretations given to these powers and the employer’s willingness and ability to fund at higher levels meant that the dispersion within which schemes were funded was very wide.

47. The pace of funding, or the level to which a scheme was funded, was a major factor in determining the level of security for members’ benefits in that scheme.

**Actuarial valuations**

48. Formal actuarial valuations involved the carrying out of calculations on a number of possible different funding measures by the scheme actuary.

49. However, in essence any actuarial valuation had two main purposes:

- to compare the liabilities for benefits that members have accrued in respect of their service to date against the assets in the scheme at the same date (known as a past service valuation); and

- to value the liabilities for benefits that active members will accrue in respect of future service.

50. This enabled the scheme actuary to make recommendations on the funding – that is, the contributions – required to be paid for the future service benefits with possible adjustments upwards or downwards to take into account the deficit or surplus of assets held to meet the past service liabilities.

51. In order to make these assessments, the scheme actuary made assumptions about how the scheme would develop in the future.

52. For an MFR valuation, these assumptions were prescribed. However, for an ongoing valuation the scheme actuary would make assumptions – about such things as future wage growth, life expectancy, future increases to pensions once in payment, the probability that people would leave by early retirement, retirement at the normal scheme age or by other means – in order to project forward the cash flows out of the scheme.
53. Having projected forward the cash flows from expected benefit payments, the scheme actuary then ‘discounted’ these future payments back at an assumed rate of interest in order to give a ‘capital value’. The capital value of the liabilities earned in respect of service up to the valuation date was commonly called the value of the past service liabilities.

54. In considering the asset value, the scheme actuary would typically either take the market value of the assets (as provided by the auditor in the scheme accounts) or the ‘assessed’ or ‘actuarial’ value of the assets.

55. The ‘assessed’ or ‘actuarial’ value took the income from the assets and projected it forward using assumptions about growth (equity dividends, property rental income and so on) and inflation and then discounted this income stream back at the valuation rate of interest to give a figure which could be compared with the past service liabilities to assess whether a surplus or deficit existed.

**Different funding measures**

56. A formal valuation exercise generally included the production of valuation results on several different measures for different purposes. These could be broken down into two main categories as follows:

- ongoing valuations: with liabilities valued assuming that active members remain in service – in order to check that the pace of funding is on track; and

- discontinuance valuations: with liabilities valued assuming that active members leave active service immediately – principally as a check on the security of benefits.

57. An ongoing valuation typically made allowance for future wage inflation in projecting forward active members’ benefits from the valuation date to their eventual retirement date. Discontinuance valuations, on the other hand, treated active members as having left employment; that is, as deferred pensioners. The projection of such benefits therefore only allowed for statutory deferred pension increases.

58. The valuation rate of interest for placing a capital value on the discontinuance liabilities depended on the nature of the valuation. There were three common bases on which discontinuance valuations were made. These related to either a position where the liabilities were run off on a ‘closed scheme’ basis, or where they were secured by the payment of transfer values, or where they were secured by the purchase of annuities.

59. Prior to the abolition of tax credits on UK equity dividends in 1997, ongoing valuations typically used a discounted income value of assets (see above). This reflected the longer term nature of these valuations and a desire to smooth out market volatility in the asset valuation.

60. Subsequently, the use of market values (or market-related values) became increasingly common in ongoing valuations.

61. However, discontinuance valuations were designed to show a current or at least a much shorter term view of the scheme’s financial position. As such, they more commonly used market values of assets.
62. Tax approved occupational pension schemes were also required to carry out an assessment of their funding position against a prescribed surplus valuation basis. The legislation for this statutory surplus test was designed to prevent over-funding and schemes risked the loss of tax relief if they found themselves over the prescribed limit.

Disclosure of valuation results and related guidance

63. Scheme actuaries are bound by the professional guidance issued by the Faculty and the Institute of Actuaries on what they need to include in their valuation reports to trustees. The relevant professional Guidance Note is GN9, of which version 5.1 was current for valuations signed from 1 June 1994 until 31 July 1997 and version 6.0 was current for valuations signed from 1 August 1997 until 19 March 2004.

64. There are a number of sections of version 6.0 of GN9 which have particular relevance to this investigation:

2.1 The purpose of the Guidance Note is to ensure that reports contain sufficient information to enable the current funding level of a scheme to be understood and also, in the case of a defined benefit scheme, to enable the expected future course of a scheme’s contribution rates to be understood. It is not intended to restrict the actuary’s freedom of judgement in choosing the method of valuation and the underlying assumptions...

3.1.3 A report on a scheme subject to the Minimum Funding Requirement may incorporate the actuary’s statement (prepared in accordance with Guidance Note GN27) on that Requirement if it is appropriate to do so, i.e. the prescribed calculations have been made by the appointed Scheme Actuary and the report is addressed to the trustees. Care should, however, be taken that the results of calculations with different objectives are clearly identified...

3.4.1 In the case of a defined benefit scheme, the report should explain the funding objectives and the method being employed to achieve those objectives. A statement should be made as to the extent to which there have been changes in the objectives or the method since the last report of a similar nature. Implications in terms of stability of contribution rates and of future funding levels should be explained. If the scheme is subject to the Minimum Funding Requirement, comment should be made on the difference from the objectives of that requirement...

3.7.1 In the case of a scheme subject to the Minimum Funding Requirement, the Minimum Funding Requirement funding level as given in the most recent statement should be stated with appropriate explanation.

65. Under the heading ‘current funding level – discontinuance assumption’, GN9 stated:

3.8.1 The purpose of the statement on this subject is to give an indication of the accrued solvency position of a scheme in discontinuance or were the scheme to become a scheme in discontinuance at the valuation date and, in particular, if there were no further contributions due from the scheme sponsor. The actuary should adopt an approach with that principle in mind.
66. The actuary is further required to give an opinion on whether the assets would have been sufficient to cover the discontinuance liabilities of pensioners, deferred pensioners and active members. If the assets were not sufficient, an indication of the level of coverage was to be included.

67. The statement of which liabilities are covered in this way needed to reflect the priority order for securing benefits that applies in a winding up. At a basic level, pensioners’ benefits would be secured fully with remaining assets being used to secure deferred and active members’ benefits.

68. Under the heading ‘current funding level – on-going assumption’, GN9 stated:

3.9.1 If the scheme is not already in discontinuance, the report should include a statement as to the funding position on the assumption that both scheme and the scheme sponsor(s) are on-going. The statement should include, where relevant, a comparison between assets and accrued liabilities, the latter with pensionable salaries projected where appropriate to assumed end of pensionable service, if this is not otherwise conveyed by the comments on the funding objectives and the contribution rate.

69. Valuation reports were therefore required to provide trustees with information on the different funding measures and the differences between them – and members had the right to request copies of actuarial valuation reports.

70. Regulations also required an ‘actuarial statement’, as appended to the valuation report, to be included in the scheme’s annual report and accounts. These accounts were also disclosable to members.

71. Version 6.0 of GN9 contains guidance to actuaries preparing these actuarial statements including the following:

4.3 ...the Statement requires an opinion from the actuary on the adequacy of the resources of a scheme “in the normal course of events”. In interpreting this expression at the date of each Statement, the actuary should take a prudent view of the future without taking into account every conceivable unfavourable development...

4.5 Care should be taken to avoid confusion between MFR liabilities, liabilities on an ongoing valuation basis and discontinuance liabilities.

72. Again the actuary was required to make sure that the reader was aware of differences between the different funding measures.

MFR: actuarial methodology and assumptions

73. The MFR became operational from 6 April 1997. However, much of its development took place before then to allow for consultation and time for actuaries to become familiar with the MFR and to update their systems.

74. The methodology and actuarial assumptions for the MFR test, and for determining the statutory minimum level of employer contributions, were during the relevant period
prescribed by The Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996, which referred to a mandatory actuarial guidance note (GN27) for the technical actuarial details underlying the calculations.

75. The specifics of the methodology and assumptions underlying the MFR calculations were contained in the actuarial guidance note and were set by the actuarial profession — the Faculty and Institute of Actuaries — with the approval of the Secretary of State.

76. The actuarial profession’s remit was to devise a methodology and assumptions which met the Government’s objectives for the MFR and which:

- did not impact unduly on compliance costs for employers;
- was consistent with the actuarial valuation methods that were in practice at that time (hence a methodology based on a true market based model was not considered, as such methods were not commonly in use for ongoing valuations at that time);
- did not rely on complex mathematical models for compliance (hence the MFR methodology did not explicitly tackle market value volatility);
- took account of instructions from Government on the extent to which the MFR basis should include an equity risk premium, that is the expected out-performance of equities relative to gilts (advice to DSS from the Pensions Board of the actuarial profession had been that, if it were desired to give the member increased security, then a greater weighting would be required in bonds with a consequent increase in compliance costs); and
- was objective in its nature to the extent that different actuaries should not produce answers which were more than 2% different given the same data.

77. When the MFR was introduced, its basis was also used to provide a ‘floor’ to the calculation of cash equivalent transfer values (CETV) when an individual left a scheme and transferred his or her benefits to another suitable pension arrangement.

78. From 6 April 1997, a CETV had to be underpinned by the value of the MFR liability in respect of the member to whom the CETV related — except if the scheme was not fully funded on the MFR basis, in which case the transfer value could be reduced to reflect this under-funding.

79. Legislation introduced a change to the calculation of the debt (if any) due from the employer to the pension scheme when a scheme starts to wind up. From 6 April 1997, the amount of such a debt was calculated as the difference between the amount of the scheme’s assets and the value of its liabilities calculated on the MFR basis.

**MFR valuations**

80. The past service valuation under the MFR specified that:

- a) the pension scheme assets were taken at market value;
b) pensions in payment were generally valued as if they were backed by long dated UK Government stock (‘gilts’) and without allowance for the possible higher returns that other asset classes such as equities might produce;

c) accrued benefits for non-pensioners – that is, active members who were still in service and deferred members who had left employment – were valued as if they were backed by UK equities before retirement and by gilts once in payment (unless the scheme’s trustees had formally adopted a ‘gilts-matching’ investment strategy); and

d) a prescribed expense allowance equal to a percentage of the calculated liabilities was added on to the liabilities.

81. The past service MFR valuation result was therefore derived from a) – b) – c) – d). If the answer were positive, there was an MFR surplus and the MFR funding level, calculated as \( \frac{a}{(b + c) + d} \), would be greater than 100%. If the answer were negative, there was an MFR deficit and the MFR funding level would be less than 100%.

82. One of the purposes of an actuarial valuation was to recommend the contributions to be paid to a scheme in the future taking into account the cost of benefits that would accrue to members in respect of future service and an adjustment up or down for any past service deficit or surplus.

83. The MFR also did this by prescribing calculations for the minimum contributions (to be certified by the scheme actuary) in a scheme’s schedule of contributions. The broad purpose of determining MFR minimum contributions was to determine the contributions required to get a scheme back to an MFR funding level of 100% (or to keep it above this level) within prescribed periods.

84. However, this aspect of the MFR only set a minimum level of contributions. The actual level of funding was generally a matter for discussion between the scheme’s trustees and its sponsoring employer(s), in accordance with the terms of their own trust deed and rules. In some cases schemes were, some time after the MFR came into force, only funded at the MFR minimum level, whereas others were funded at levels well in excess of this.

MFR methodology

85. The prescribed basis for carrying out MFR valuation calculations was set out in the actuarial profession’s GN27.

86. The calculations were different for pensioners and non-pensioners. The following represents a summary of the main principles that applied to the majority of pension schemes. However, other complications existed, such as ‘gilts matching’ and an easement for valuing pensioner liabilities for larger schemes.

87. A gilts-based valuation was prescribed for pensioners’ liabilities using market yields, taken from the FTSE Actuaries range of gilt indices, at the MFR valuation date. These yields were used as the rate of return, also known as a ‘discount rate’, for placing a capital value on the liabilities.
Compared with ongoing funding bases, in use at the time of the introduction of the MFR, this approach to valuing pensioner liabilities represented quite a strengthening, i.e. an increase in liability values. At the introduction of the MFR in April 1997, this also provided a reasonable approximation to the cost of securing pension benefits by purchasing annuities.

The valuation for non-pensioners used the principle of first calculating a capital value using long term assumptions which were specified in GN27. These long term values were then adjusted through the use of market value adjustments (MVAs) into liability values that were then intended to reflect market conditions at the calculation date.

The principal long term return, or discount rate, assumptions for valuing non-pensioner MFR liabilities, as prescribed in GN27, were as follows:

- the effective rate of return on equities before MFR pension age was to equal 9% per annum; and
- the effective rate of return on gilts after MFR pension age was to equal 8% per annum.

The calculated liability value was then adjusted to smooth the jump between the two rates of return in the ten years before MFR pension age. MFR pension age was defined as the earliest age from which a member may retire, as of right, taking all of his or her benefit without actuarial reduction for early payment.

As noted above, instructions were given by Government to the actuarial profession on the extent to which the MFR basis should include an equity risk premium to reflect the expected out-performance of equities relative to gilts.

This equity risk premium was set at 2% per annum but deducting an annual allowance of 1% for the expenses of investing in a personal pension vehicle resulted in the 1% annual net equity risk premium shown in the long term assumptions above.

Market value adjustments

The rates of return above were selected as the long term assumptions for valuing non-pensioner liabilities and then they were adjusted using MVAs to reflect current market conditions.

In this way, the MFR set out to produce a market-consistent valuation where both the asset and liability sides of the valuation balance sheet reflected market conditions at the calculation date.

For non-pensioners more than ten years under MFR pension age, only one MVA came into play – the equity MVA. For members within ten years of MFR pension age, a combination of two MVAs (the equity MVA and the gilt MVA) was used.

The gilt MVA depended on the financial nature of the benefits. Effectively the gilt MVA was different for benefits that had fixed increases in payment and those where increases were index-linked.
- the fixed interest gilt MVA was the value at the annualised yield on the FTSE Actuaries Government Securities 15-year Yield Index of a 15-year stock with coupon equal to the long term rate of return on gilts; and

- the index linked gilt MVA was the value at the annualised yield on the FTSE Actuaries Government Securities Index-Linked Real Yield over 5 years (5% inflation) Index of a 15-year stock with coupon equal to the corresponding long term MFR real rate of return on index-linked gilts.

98. A further variation existed for lump sum retirement benefits (although this did not refer to tax free lump sums which could be taken by the member as an option).

**Contracting-out**

99. The employment of an earner who is a member of an occupational pension scheme may, if their employer so elects and certain statutory requirements are satisfied, become contracted-out employment, with the result that a lower rate of national insurance contributions will be made to – and a lower rate of retirement pension will be received from – the state scheme.

100. Prior to November 1986, employment which qualified an individual for membership of a final salary scheme could only become contracted-out if the relevant scheme satisfied two tests:

- the ‘requisite benefit test’, which involved the provision of at least one-eightieth of pensionable salary for each year of pensionable service; and

- the ‘guaranteed minimum pension’ or ‘GMP’ test, which involved the scheme providing a pension broadly equivalent to the additional state pension entitlement being given up.

101. After November 1986, the requisite benefit test was abolished and, from then until 6 April 1997 upon the commencement of the Pensions Act 1995, a scheme had only to meet the GMP test.

102. From 6 April 1997, final salary schemes wishing to contract-out were once again required to meet a test of scheme quality, called the ‘reference scheme test’, which aimed at ensuring that a certain overall level of benefits would be provided for members of the scheme generally.

103. From the same date, the GMP requirement was abolished, although GMP entitlements accrued up to and including 5 April 1997 were retained within the scheme after that date.

104. In order to deduct and pay national insurance contributions at the reduced rate, an employer must have a valid contracting-out certificate, which have been issued since 6 April 1997 by the Secretary of State.

105. Each certificate stated both an employer reference number (known as an ECON) and a scheme reference number (known as an SCON). An employer will only have one ECON but may sponsor more than one scheme and so may have more than one SCON. These reference numbers are the principal ways in which NICO monitor national insurance contributions and liabilities to secure contracted-out rights.
106. A scheme qualified to contract-out of the state additional pension:

- in relation to service completed before 6 April 1997, where it complied with the requirements of the Pension Schemes Act 1993 related to the provision of GMPs and where its rules related to GMPs were framed so as to comply with any requirements laid down by NICO in relation to contracted-out matters; and

- in relation to service completed after 6 April 1997, where NICO was satisfied that:
  i. the scheme met the ‘reference scheme test’;
  ii. the scheme was subject to, and complied with, the provisions of the Pensions Act 1995 regarding employer-related investments;
  iii. the scheme was funded to the MFR level or would, in the opinion of its actuary, be so within a period specified in the scheme’s schedule of contributions, usually within five years (although there was a transitional period during which schemes were initially allowed a longer period to get their funding position back on track);
  iv. the scheme did not permit the payment of a lump sum instead of a pension, unless the amount were trivial or otherwise allowed by Inland Revenue rules;
  v. the scheme provided benefits payable by reference to an age that was equal for both men and women and otherwise permitted by Inland Revenue rules; and
  vi. the rules of the scheme were framed in such a way as to comply with any requirement prescribed by NICO as to contracted-out matters.

107. For the period of service from April 1978 to April 1997, a contracted-out defined benefit scheme had to ensure that the benefits provided to each member for that period were at least as good as the GMP.

108. The law also provided that GMPs in payment which were attributable to service completed since 6 April 1988 had to be increased each year by the lesser of the retail prices index and 3%.

109. GMP entitlement was calculated according to a pension scheme member’s ‘earnings factors’ during the relevant period – which were derived from an individual’s earnings between the lower and upper earnings limits specified in legislation, revalued in accordance with the increase in the earnings index over the relevant period. A member was only entitled to GMPs in respect of periods of contracted-out pensionable service where the member’s earnings exceeded the lower earnings limit.

110. The basis on which the GMP earnings factors were calculated changed in 1988 and so separate calculations for each individual must be made in respect of service prior to and after this date. The method of calculation was:

- for those within twenty years of state pension age on 6 April 1978, 1.25% of their revalued earnings factors for each year between 6 April 1978 and 5 April 1988 plus one per cent of their revalued earnings factor for each year between 6 April 1988 and 5 April 1997; and
for others, 25% of their revalued earnings factors for each tax year between 6 April 1978 and 5 April 1988, divided by the number of complete tax years after 5 April 1978 (or the start of working life) up to state pension age, plus 20% of their revalued earnings factors between 6 April 1988 to 5 April 1997, divided by the number of complete tax years after 5 April 1978 (or the start of working life) up to state pension age.

Thus, while GMPs were broadly equivalent to SERPS entitlement, they were not calculated in the same manner.

A scheme member would be treated as having terminated contracted-out employment:

- where their contract of employment expired or was terminated; or
- in the absence of such a contract, where the employment had itself been terminated; or
- where the individual had ceased to be a member of a contracted-out scheme; or
- where the certificate by virtue of which the individual’s employment had been contracted-out of the additional state pension had been surrendered or cancelled; or
- where the relevant certificate had been varied in such a way that it no longer covered the particular employment of that individual; or
- where the employment could not be treated as continuing in circumstances in which a firm was taken over or otherwise ownership or activity were substantially altered.

Where a member’s pensionable service terminated after they had completed two years of qualifying service, that individual was entitled to a preserved benefit under the scheme which had to be appropriately secured. If an individual left pensionable service prior to the completion of two years, then they would normally only be entitled to a refund of their own contributions.

The options available for securing the contracted-out rights of early leavers were fourfold:

- reinstatement into the state additional pension – by means of a contributions equivalent premium (although after 6 April 1997, it was only possible to buy an employee back into SERPS if they had served less than two years and had received a refund of their own contributions on leaving the scheme – prior to this, it was possible to buy any member back into SERPS by way of a State Scheme Premium);
- the purchase of a deferred annuity from an insurance company;
- retention of liability within the scheme – where the member became a deferred member of the scheme; and
- transfer to another contracted-out pension arrangement – whereby the individual’s accrued rights were secured outside the scheme by membership of another occupational or personal pension scheme.
Key aspects of the relevant regime

115. A winding up of a final salary occupational pension scheme occurs when a scheme is terminated and its assets are used to secure the scheme’s benefits through other means.

116. Final salary occupational pension schemes may be wound up for four principal reasons: first, as a result of a decision to do so by scheme trustees; secondly, as a consequence of the merger or restructuring of the sponsoring employer(s); thirdly, due to a decision to discontinue the provision of an occupational scheme by the sponsoring employer; and, finally, as a result of the insolvency of the sponsoring employer.

117. The subject matter of this investigation is related to schemes which have either wound up due to a decision by the sponsoring employer or as a result of the insolvency of that employer.

118. The events which will trigger the voluntary winding-up of a scheme depend on the scheme’s governing trust deed and rules but typically involve formal notification by the employer to the trustees that it requires the scheme to be wound up. Where a scheme is wound up due to the failure of an employer, this is triggered when a relevant insolvency event – for example, the commencement of the employer’s bankruptcy or the liquidation of it – occurs. Where winding-up began after 5 April 1997, statutory provisions related to the winding-up process over-ride any particular scheme rules which are not consistent with those provisions.

119. Where any scheme winds up, trustees must take action to secure all a scheme’s assets – that is, to realise its investments and to ensure that all contributions due to it have been made – and then to discharge its liabilities to beneficiaries of the scheme.

120. In some schemes, winding-up can be achieved by securing the pensions of those already retired through the purchase of annuities and by providing a full cash transfer value to – or by the purchase of a deferred annuity on behalf of – non-pensioner members. Where a scheme winds up under-funded, it may not be able to secure the full accrued benefits. The schemes which form the focus of this report are those in which there are not enough assets to meet all of the scheme’s liabilities.

121. There are two aspects of the statutory regime related to final salary occupational pension schemes, not described above, which are relevant to the subject matter of this report. These are:

(i) that relating to the insolvency of sponsoring employers and the realisation of a pension scheme’s assets; and

(ii) that relating to the winding-up of schemes and the discharge of their liabilities.

Realising a scheme’s assets

122. Where a scheme seeks to realise its assets, its investment managers may liquidate the scheme’s investments which will then be valued by the scheme auditor. The scheme actuary will then calculate whether monies are due from the sponsoring employer(s) in order to bring the scheme up to funding at the MFR level.
123. If the value of the scheme's assets was certified by the scheme actuary as being less than the value of its liabilities as defined in legislation and as measured with reference to the MFR, the difference became a debt due from the employer to the scheme trustees.

124. Where the sponsoring employer is still trading, trustees may take legal action to enforce the debt.

125. Where the employer is insolvent, the law provides for the way in which such an employer's assets must be apportioned between its various creditors.

126. Prior to 15 September 2003, the assets of companies that were being wound up were discharged according to the following order of priority:

(i) first, to meet the costs and expenses of winding the company up;
(ii) secondly, to meet debts due to preferential creditors;
(iii) thirdly, to meet debts due to ordinary creditors;
(iv) fourthly, to pay post-liquidation interest on debts due to preferential and ordinary creditors;
(v) fifthly, to meet debts due to deferred creditors; and
(vi) finally, to make payments to members of the company in accordance with their rights.

127. Priority was given to secured debts, that is, those loans, mortgages and other debts that were secured on the assets of the company.

128. During this period, the preferential creditors were, in order of priority: debts due to the (former) Inland Revenue in respect of employees' tax deductions; debts due to (the former) HM Customs and Excise in respect of VAT and other excise duty; outstanding national insurance contributions; certain unpaid contributions due to an occupational pension scheme in the year prior to the insolvency; outstanding payments to a company's employees; and levies due to the EU for industrial production.

129. Where insufficient funds were available to meet all a company's liabilities, the secured debts were discharged in full before discharging those unsecured debts given preference and, if any monies were remaining, ordinary creditors would receive a proportion of the remnant.

130. Legislative change that had effect from 15 September 2003 abolished the Crown's preferential rights in all insolvencies and made provision to ensure that unsecured creditors received a larger proportion of the assets being discharged in the insolvency proceedings.

Discharging a scheme's liabilities

131. Where there are insufficient assets to secure all the liabilities of a pension scheme, there is a statutory order in which a scheme must discharge what assets it has. The priority order was modified following commencement of the 1995 Act’s provisions and this modified priority order was supposed to be in place during a transitional period from April 1997 to April 2007. However, this order has, with the commencement of the 2005 Act’s provision, now been
replaced as part of the reform of the statutory provisions governing final salary schemes in wind-up.

132. After meeting scheme expenses and debts to third parties, the transitional order of priority was:

(i) pensions in payment (excluding increases in those pensions) and any liabilities for pensions or other benefits derived from voluntary contributions;

(ii) pensions or benefits paid by insurance contracts purchased before April 1997 that cannot be surrendered or where the surrender value does not exceed the liability secured by the contract;

(iii) a transfer value for non-pensioners (derived on an MFR basis) of Guaranteed Minimum Pension (GMP) entitlements and post-April 1997 contracted-out rights;

(iv) increases on pensions in payment;

(v) increases in the value (on an MFR basis) of non-pensioners' GMP and post-April 1997 contracted-out rights;

(vi) a transfer value (derived from the MFR) of pre-April 1997 accrued pensions not derived from GMPs; and

(vii) the residual buy-out costs of other deferred benefits.

Reconciling contracted-out entitlements on wind-up

133. In order to be able to discharge a scheme’s liabilities to its beneficiaries, the trustees of a scheme in wind-up must calculate the entitlements of each scheme member within each category.

134. When a scheme ceases to contract-out, the scheme administrators or trustees must notify Her Majesty’s Revenue and Customs in writing. Prior to May 2003, notification of cessation was directed to NICO Elections Section. However, as part of the Government’s ‘Joint Working Initiative’, NICO Elections work was merged with and transferred to Her Majesty’s Revenue and Customs’ Savings, Pensions and Share Schemes section, which had been responsible for granting tax approval for pension schemes. The merger introduced a single point of contact for its customers on contracting-out election and tax approval matters.

135. On receipt of written confirmation that a pension scheme has ceased to contract-out, Her Majesty’s Revenue and Customs writes to the employer, trustees and pension provider to confirm the cessation date. They then cancel the relevant contracting-out certificate and associated tax relief certificates and notify NICO of the cessation/wind-up event.

136. This formal notification is the trigger for NICO’s ‘initial action’, which is to to raise a file and enter the scheme details on the NIRS2 Benefit Scheme Provider file. NIRS2 – NICO’s computer system – identifies all individual scheme members in respect of whom the employer or scheme administrator had previously informed NICO of their details.
Scheme enquiry lists are created and appropriate pension calculations are produced and re-input schedules supplied for each individual current member if all of the earnings and contributions details are available.

These are then provided to the scheme administrator who, with trustees, will seek to reconcile the records held by the scheme with those held by NICO in respect of national insurance contributions.

Once reconciled, agreed re-input schedules are used to notify NICO formally of the methods by which the rights are to be preserved or protected. It is not necessary to secure every member’s pension rights by the same method. Trustees must provide members with information about their pension rights within the scheme and options available for preserving them. Scheme administrators must inform NICO once a decision has been taken about the arrangements that have been made, detailing the appropriate methods of preservation.

There are two main areas where queries arise: scheme administrators frequently dispute both members’ periods of contracted-out employment and pension calculations undertaken in respect of individual members. This may be a consequence of incorrect or conflicting contributions information being submitted to NICO from either the scheme administrator or the employer over a number of years.

NICO has introduced a system of ‘Customer Account Management’ and a series of roadshows and face-to-face meetings with pensions professionals in order to improve the service it provides.

NICO is also responsible for work to deal with requests for ‘deemed buyback’ calculations for members of final salary schemes in wind-up, which would restore those members into the state additional pension scheme.

An individual may be eligible for deemed buyback where the funds available to the scheme in respect of the member are less than the amount required to restore their state scheme rights for the period of contracted-out employment, where the scheme has insufficient resources to meet the MFR level, and where the amount available in the scheme in respect of the member is less than the amount which would have been available had the scheme wound up 100% funded.

If the criteria are met, NICO will on request perform and issue provisional deemed buyback calculations either for samples or for the whole membership of schemes.

NICO says that, at the time of writing, 109 schemes have met the criteria for deemed buyback. 20 schemes have been issued with full scheme calculations, 66 schemes have been issued with sample calculations and work on 8 schemes is still in progress. Of the 86 schemes that have been issued with either sample or full scheme calculations, 15 schemes have confirmed that they have no qualifying members and therefore they will not be pursuing deemed buyback.

Since November 2003, NICO have issued over 7,000 deemed buyback calculations to customers. However, to date, only 58 members have opted to pursue deemed buyback.
Annex B
Actuarial advice to the investigation

Introduction
1. This annex sets out the technical scope of – and gives further detail about – the actuarial advice I commissioned to help me to investigate complaints about the various changes to the actuarial basis of the MFR test and an alleged failure to inform scheme members and trustees of the effects of those changes.

2. The report produced by my advisers is over 60 pages long. This annex therefore can only be a brief summary of their advice.

3. The work done for me by my advisers included:
   (i) an assessment of whether the MFR – at both its original level and at those after the subsequent changes to it – provided to non-pensioner members of a final salary scheme a ‘reasonable expectation’ of achieving equivalent benefits through a personal pension on wind-up;
   (ii) an assessment of whether the principal changes to the MFR were significant; and
   (iii) an assessment of whether those changes had the effect of strengthening or weakening the protection afforded to the accrued pension rights of final salary schemes as measured on the MFR basis.

Technical scope of advice
4. This work involved the application of a stochastic model developed by my advisers (and also used by them in relation to their other work).

5. It also involved the use of statistical methods to generate a large number of possible outcomes for asset values – in this case equity and bond values – over a given term.


Assumptions used
7. At each date, they also generated the outcomes based on the economic conditions at the time, as an attempt to avoid the use of hindsight – to put them in the position that they might have been in, if they had been assessing the MFR in this way at that point in time.

8. My advisers recognise that this calibration of their modelling to the historic economic conditions cannot be perfect. The stochastic outcomes were generated by a model that itself is based around a set of long term assumptions.

9. They therefore used the same long term assumptions at each of the four dates in order to avoid introducing distortions to the results, although they advise me that, if required, they could have provided analysis on the effect of varying the assumptions.

10. As a result, there might have been minor differences in the probabilities had my advisers selected different long term assumptions.
11. I am told that it is therefore more helpful to focus on the movements in the probabilities between the different dates – rather than the absolute level of the probabilities at the starting date.

**Process of modelling**

12. The starting value (the initial investment) and the target value (the amount required to provide the deferred pension given up when the transfer value was taken) are both set with reference to values derived on the MFR basis.

13. For simplicity, the starting value was the MFR transfer value, i.e. dependent on the equity MVA, which would have been paid in respect of an accrued annual pension of £1,000, which is index-linked in payment and payable from age 65.

14. This starting value was then run through the stochastic model to generate 5,000 simulated fund values (net of investment fees and expenses) that might result from the investment of this amount, on a 100% equity basis, in a personal pension vehicle.

15. The model also allowed for the switch from equity to bond investments over the 10 years before retirement age, as implied by the MFR basis.

16. My advisers then assessed the percentage of these fund values that exceeded the MFR target value.

17. The MFR target value was calculated as the accrued pension increased, between the date the transfer value was assumed to be taken and retirement age, in line with the MFR assumption for deferred benefit revaluation (4% p.a.).

18. This projected amount was then converted to a value using the MFR pensioner basis, which is linked to gilt yields at the relevant date.

19. This then provided an assessment of the probability of the MFR transfer value being sufficient to provide the pension being given up.

**Summary of advice**

20. In relation to whether the MFR delivered the ‘reasonable expectation’ policy intention – defined as a 50% chance – for non-pensioners at the time of its conception and at the time of its implementation, my advisers tell me that, at those times, on the basis of their analysis as outlined above it is their opinion that the design of the MFR was consistent with that policy intention.

21. They also tell me that, although the MFR was a measure which was intended to test the position upon the ‘discontinuance’ of a fund, it was derived from an actuarial valuation method used for funds which were ‘ongoing’. For this reason, the MFR had a number of design flaws which meant that, whilst it delivered the policy intention at the time of its introduction, it was not robust to changing market and other economic conditions.

22. Such changes included:

   - lower inflation;
• lower nominal interest rates;
• changes in the make up of the All Share Index;
• changes in annuity buyout costs;
• the removal of tax credits on dividends; and
• changes in dividend policy.

23. In addition, they advise me that the MFR contained a ‘discontinuity’ in that the amount required to be held immediately before retirement was often less than the amount required to be held immediately afterwards.

24. In relation to the ability of the MFR to deliver the policy intention for non-pensioner members over time, my advisers firstly considered the position if there had been no changes to the MFR.

25. They calculated the change in the probability that a non-pensioner would achieve their full accrued benefits if their scheme wound up. Their advice is that (if there had been no changes to the MFR basis) the initial probability asserted by the Government of an even chance (i.e. 50%) would have fallen by March 2002 as follows:
   a) (ignoring the detrimental effect of rising annuity buyout costs) to a little under 45%; and
   b) (including that detrimental effect) to around 35%.

26. The advice to me is that the MFR’s inability to adapt to changing market conditions alone would have resulted in it reaching levels where it failed to achieve the policy intention ascribed to it.

27. My advisers then tested the effect of the changes made in 1998 and 2002. They advise me that the changes had the effect of reducing the probabilities above to just above 35% and potentially to less than 30%, respectively.

28. It is the opinion of my actuarial advisers that at that time the MFR was already failing to deliver the Government’s policy intention and that the changes exacerbated that failure.

29. My advisers then considered whether the changes were ‘significant’. They told me that the MFR was a minimum. To varying degrees, depending on the wording in schemes’ documentation, trustees had powers to enforce contribution rates higher than the minimum.

30. However, I am told that, in fact, while most trustees could take steps to reduce investment risk and thereby increase the MFR minimum contributions, few did so. In practice therefore a significant number of schemes only enforced the minimum required by the MFR.

31. I am told that, for some companies, particularly where the employer set the contribution rate, the reduced protection afforded by the changes and the 2002 extension to the period over which deficits could be corrected meant that, in practice, lower employer contributions were paid than would otherwise have been the case and some other steps available to companies and trustees were not considered.
32. I am advised that the impact of these changes would have been very scheme specific – for example, for well funded schemes they might have had very little impact.

33. However, where the MFR ‘bit’ and where employers went insolvent, it is the opinion of my advisers that the combination of the changes to the MFR formula and deficit recovery periods did constitute a significant weakening of protection to members.

34. For the Government’s policy intention to be met, my advisers inform me that the changes made by it would have needed to be in the opposite direction.
Annex C
Further DWP submissions made during the investigation and my assessment of those submissions

Introduction
1. This annex sets out certain submissions made to me by DWP during the course of the investigation – and my assessment of those submissions.

2. These relate, first, to initial concerns I had about the official information provided about the security afforded to scheme members by the MFR. Secondly, they relate to whether, had DWP provided clear, complete, consistent and accurate information – as complainants assert that it should have done – this would have prevented the injustice claimed by them.

DWP’s submissions
Official information
3. DWP’s representations in relation to my initial concerns – that official information about the degree of security provided by the MFR was not clear, complete, consistent and always accurate – can be classified as being in relation to four aspects of that information.

4. These were:
   (i) about the context in which (principally early) statements about the MFR were made and what Ministers and others meant by those early statements;
   (ii) about whether schemes of which complainants were members were in fact fully funded on the MFR basis at wind-up and thus whether official statements about the effects of being 100% funded on that basis were relevant to complainants’ positions;
   (iii) about whether all of the statements about which I had concerns were known to complainants – and whether they were referred to in their original complaints; and
   (iv) about whether trustees might reasonably have been entitled to have regard to official information.

5. DWP also made representations as to whether individuals would still have suffered loss even had they known about the risks to their pension rights following disclosure of those risks by Government. It also submitted actuarial advice, produced for it by the Government Actuary, to support those representations.

Early statements about MFR
6. In relation to the context and content of early statements about the MFR, DWP said that:

   ... It should be noted that before the 1995 Act – except for limited facilities in respect of contracted-out schemes – no general funding requirements existed for UK pension schemes, and the amount of protection depended on scheme rules and the actions or inaction of the trustees in each case.

   With no minimum requirement for funding, all categories of member, even those in a priority position at wind-up, might suffer substantial reductions in pension entitlement.
7. DWP continued:

*It is therefore understandable that Government statements at the time of the 1995 Act would tend to emphasise the fact that the MFR offered a mechanism for protecting pension entitlement.*

*However, these statements generally made a clear distinction between full protection for all members, regardless of age, and the concept of a ‘fair transfer value’ (or similar phrase) for younger members.*

8. On the former point, DWP said that Ministers had made clear that the MFR did not offer total protection and gave as an example the following excerpt from a Ministerial speech made during parliamentary consideration of the Bill that became the 1995 Act:

*Let me dispel some misconceptions about the minimum requirement. It will not provide that scheme members’ benefits can be absolutely secured in full, which would require the purchase of guaranteed insurance annuities. We accept... that that would be an unrealistic target giving rise to excessive costs for employers...*

*If the scheme is at least 100% funded on the statutory basis, pensioners can expect their pensions to continue to be met in full, while younger scheme members will be entitled to a fair actuarial value of their rights which they can then transfer to another scheme or to a personal pension.*

9. DWP said that a ‘fair actuarial value’ was not the same as an expectation of full benefits for all scheme members. DWP said that the idea of ‘fair’ or ‘reasonable’ value related to an even chance that non-pensioners would secure at least the value of their accrued rights in the scheme at retirement.

10. Moreover, DWP said that the various other parliamentary statements at this time, which mentioned ‘fair value of accrued rights’, or ‘actuarial value of accrued rights’ needed to be seen in this context.

**Funding position of complainants’ schemes**

11. DWP said that schemes could comply with the MFR legislation notwithstanding that they were at any one time funded below MFR levels, as the relevant legislation had only required them in such circumstances to have a schedule of contributions that would bring the scheme funding up to at least the MFR level over a specified period.

12. DWP said that it was also worth noting that the MFR regime did not immediately apply to all schemes; under transitional arrangements, schemes had not been required to undertake their first MFR valuation until approximately three years after their last valuation on the pre-April 1997 basis.

13. In other words, individual schemes that wound up may not in any case have been funded to the level at which it is alleged that a ‘false sense of security’ existed.
14. DWP said that they could have been – and probably were – funded to less than that level; or (until 1999/2000) they might still have been funded on a pre-MFR basis and would never have operated on the basis of an MFR valuation.

15. Furthermore, DWP said that their official statements about which I had concerns were made in relation to the aim of the MFR policy in respect of schemes that were funded to MFR levels. However, DWP said that, in practice, it was their understanding that most, if not all, of the schemes whose wind-up had given rise to complaints to me were below (and possibly significantly below) the MFR funding level when they went into wind-up.

16. Thus, DWP did not consider that statements about the level of protection afforded to schemes in a position not similar to those of which complainants were members were relevant to the current position of those complainants.

Complainants’ knowledge of leaflets

17. In addition, DWP said that some of the early information about the 1995 Act was long out of print and, as far as it was aware, had been withdrawn from public use some years before the time of the events which gave rise to the complaints, let alone the time the complaints to me were made.

18. Moreover, DWP said that it was surprised that official statements which were alleged to have an important opinion-forming role and which apparently influenced trustees and scheme members to take or not to take significant financial decisions had not been emphasised in the original complaints.

The position of trustees

19. DWP told me that it did not accept that any statements made about the MFR could reasonably have given trustees a false sense of security.

20. DWP said that every certificate prepared by a scheme actuary when undertaking an MFR valuation had to include a statement to the effect that the valuation did not reflect the cost of securing full buy-out of liabilities in the event of wind-up. Furthermore, every certificate showing the adequacy of a schedule of contributions had had to include a similar statement and, from May 1999 onwards, the OPRA ‘Guide to the Minimum Funding Requirement’ had stated that achieving MFR funding levels did not necessarily ensure that all liabilities could be met on wind-up.

21. Given this, DWP said that trustees should have been aware that on winding-up, scheme members would not necessarily be entitled to the full buy-out value of their accrued rights even if the scheme was fully funded on the MFR basis.

Whether disclosure would have prevented injustice

22. DWP put it to me that individuals might still have suffered losses, even had the information provided to individuals by public bodies been clear, complete, consistent and accurate.

23. DWP submitted analysis done by the Government Actuary to support the proposition that anyone leaving a final salary scheme that did not wind-up would have suffered financial loss by
doing so. This complements the submissions made to me earlier in the investigation by DWP that the actions which complainants typically claim they might have taken if they had been warned about the risks associated with employer insolvency were important actions with very significant personal financial risks and implications.

24. DWP said that, had their official information contained a warning about such risks, this would have been no use to individual scheme members. Worse, it might have had significantly adverse consequences for both individuals and occupational final salary schemes generally, because it could have given no clue as to which schemes might in practice be affected. In its most general sense it might potentially have applied to virtually every scheme, hardly any being in a position in 2002-3 to fund to full buy-out levels in the event of the sponsoring employer immediately becoming insolvent; and it might well therefore have intimidated individuals in a wide range of schemes into thinking that their pensions were at risk, with the result of encouraging them to leave these schemes.

25. However, DWP said that leaving an occupational scheme in such a way was – in any normal circumstances – a decision fraught with financial risk. Such a decision should certainly not have been taken without serious thought and only after seeking advice, as one would almost invariably lose their employer’s contributions going forward; one would be obliged to take out a personal pension and thus assume all the risks of transferring out of a defined benefit into a defined contribution scheme – principally investment risks, but also expense and mortality risks; and one would be required to take a transfer value which would reflect the overall funding level of the scheme at the time of the departure – which was unlikely to be robust if the reason for leaving was fear of impending insolvent wind-up.

26. DWP further said that I should consider the issue of relative loss and the limited choices available to individuals who might have left their occupational pension scheme in the light of full disclosure of risk. DWP said that the examples set out in GAD’s analysis suggested that, in the prevailing circumstances, reductions to the benefits available at wind-up would have had to be substantial for members to have incurred materially greater losses by staying in the scheme rather than leaving it early.

27. DWP said that it believed that GAD’s analysis illustrated two very important points: first, that, as with decisions such as to contract out or contract in, the specific circumstances of individuals making decisions between different types of pension scheme needed to be examined carefully. It could not be assumed that individuals necessarily suffered a greater loss – by being members of a scheme which wound up under-funded – than they would have done if they had made some other choice in the months or years before the insolvency occurred.

28. Secondly, this showed that a general warning about insolvency risk in DWP literature could easily have intimidated members of those schemes (DWP said that this constituted at least 95% of the total throughout the period in question) which did not in the event wind-up, whether under-funded or not.

29. DWP said that, if such people had decided to leave their scheme, such a decision would almost inevitably have left them worse off.
My assessment of these submissions

30. I have carefully considered these submissions by DWP, but I am not persuaded by them.

Early statements about the MFR

31. I turn first to DWP’s submission that reference in some Ministerial statements and in some later official publications to the aim that, if their scheme were funded to the MFR level, a non-pensioner would receive a transfer value of a ‘fair value’ or ‘reasonable value’ of their accrued rights meant that this would only give them an even chance of replicating their lost benefits on retirement.

32. First, my actuarial advisers tell me that, in their professional opinion and from their experience of actuarial work, the term ‘fair actuarial value’ is not a technically defined term within the actuarial profession. In their view, an ‘actuarial value’ is no more than a reference to a value placed on an asset or liability, due to be paid in the future in certain circumstances, as calculated by an actuary. Without further explanation of the reasons for and the assumptions behind the calculation, there was no single generally accepted actuarial interpretation for what such a value might be.

33. In addition, I am aware that a ‘fair value’ in the financial markets is generally accepted to refer to the amount of money for which an asset or liability could be exchanged with a knowing and willing third party, in an arm’s length transaction. Whilst there may be some variations on this, I also understand that this is broadly the commonly accepted definition of that phrase within the accounting profession.

34. Secondly, I do not think that any commonsense reading of either term would lead to a clear understanding that non-pensioners would only have an even chance of replicating their pension benefits by investing the cash equivalent transfer values that they would receive were their scheme to wind-up funded to the MFR level. Even if the explanation proffered by DWP in its submission was the intended meaning behind those statements as to what non-pensioners would receive, this would be an unclear and potentially misleading formulation, which might in itself have constituted maladministration.

35. I therefore do not accept that the use of the words ‘fair actuarial value’ could have been unambiguously interpreted by actuaries or by others in the way that DWP now suggests.

The position of trustees

36. I now turn to DWP’s submission on whether trustees might have been misled by OPRA’s publications or by other official pronouncements on the issues relevant to this investigation.

37. On the one hand, I recognise that scheme trustees were in a different position to individual scheme members who were not trustees, in that they had access to professional advice and also to the funding and valuation certificates to which DWP has referred. I am advised that scheme funding and valuation certificates were rarely requested by scheme members but that trustees were indeed required to have regard to them.

38. On the other hand, I note that it was recognised in DSS research, published in September 2000, that trustees’ knowledge of their duties varied. Furthermore, the Myners report,
commissioned by Government, showed that the majority of trustees had received less than three days’ training. It also recognised that more than three-quarters of trustees had no in-house professionals to assist them and were thus reliant on securing advice from external and often costly commercial advisers.

39. Moreover, I also note that OPRA had recognised in July 1999 that, while professional advice was often necessary, ‘trustees still need a grasp of the subject to be able to ask the right questions and understand fully the advice they are given’.

40. In addition, I consider that member-nominated trustees – who were usually scheme members and not pensions or business professionals – were in a substantively different position from those appointed by sponsoring employers. I also note that the actuarial profession had as early as March 1995 warned the Government that a signed minimum funding certificate might give a misleading impression to scheme members.

41. Having considered these matters carefully, I do not accept that a requirement on trustees to seek professional advice or to have regard to various certificates can mean that information issued by a regulatory body or by other official bodies can reasonably be incomplete, misleading or inaccurate – and that this requirement might absolve those providing any such information from a finding of maladministration.

42. This is reinforced by the – in my view quite proper – recognition by the regulatory body that trustees would need to know what questions to ask before such advice or certificates could properly be understood.

43. It also seems to me that official publications issued by those responsible for the legal and regulatory regimes in which pension schemes operated were a reasonable source of information about the issues that affected pension scheme trustees and that trustees might therefore be expected to rely on them.

**Scheme funding levels**

44. I now turn to DWP’s submission that the schemes of which complainants are (or were) members were all funded to a level below – or considerably below – the MFR level. I also consider whether, if that were the case, statements concerning the security offered by being funded to the MFR level were relevant to their complaints.

45. First, where a scheme was funded below the MFR level, it is not the case that scheme members would necessarily have had no regard to official information about what was denoted by being funded to that level.

46. If a scheme was, for example, 95% funded on the MFR level, it seems to me reasonable to assume that a scheme member might consider that any shortfall that would occur on scheme closure might be minimal (that is, approximately 5%), if they believed that any scheme could meet all of its liabilities on wind-up if it were funded at the MFR level.

47. It seems to me also reasonable to assume that a scheme member would make other assumptions about the security of their pension rights. They might have done this by,
example, a direct comparison of the position of their scheme against the 100% MFR level that official information told them was a benchmark that would enable their scheme to have sufficient assets to meet its full liabilities.

48. Therefore, for those members of schemes which wound up below 100% on the MFR basis, I do not consider that official information about the degree of security that being funded to the MFR level provided was irrelevant to their position or is now unrelated to their complaint.

49. Secondly, and more importantly, it is not the case that those who have complained to me are or were all members of schemes that were funded to well below the MFR level on wind-up.

50. In relation to the four schemes of which the representative complainants were members, I have only been able to ascertain to my satisfaction the position as regards two of those schemes – those of which Mr G and Mr B were members.

51. In relation to Mr G’s scheme, it was finally valued at 101% on the MFR basis. Mr B’s scheme was finally valued at just over 100%. As can be seen from chapter 2, Mr G may only receive 24% of his expected pension and Mr B – without ‘assistance’ from the FAS – may only receive approximately 10%.

52. In relation to Mr J’s scheme, I am aware that his scheme was not fully funded on the MFR basis and that a substantial shortfall existed on wind-up. However, I am not aware of the current position or the exact funding level in either that scheme or in that of which Mr D was a member.

53. In addition, the schemes of which other complainants were members were by no means all funded below 100% on the MFR basis. For example, in relation to those among the random sample of schemes whose records I scrutinised (see chapter 3) and where information is available, it appears that the majority of those schemes were valued as being near to, at, or above the MFR level.

54. In another scheme funded above the MFR level, at least seven of whose members have complained to me, non-pensioner members are likely to receive approximately 80% of the ‘Guaranteed Minimum Pension’ in respect of national insurance contributions and nothing at all for their other contributions. I have also seen at least ten similar cases of schemes that were funded at or above the MFR level but where non-pensioners are likely to receive a significant shortfall in their expected pension.

55. Furthermore, perhaps one of the best known examples is the ASW Sheerness scheme, which was 104% funded on the MFR basis but where non-pensioners are likely to receive only a minimal proportion of their expected pensions.

56. This position – that schemes funded to the MFR level would not necessarily be able to pay to non-pensioners the value of their accrued rights – was something recognised in private by Government at the time and was, my actuarial advisers tell me, inherent in the design of the MFR.
57. This was reflected, for example, in a letter from GAD to DSS in June 1999, in the actuarial report seen by OPRA in draft that was produced in November 1999, in the September 2000 MFR consultation issued by DWP and the Treasury, and in the actuarial profession’s briefing paper for DWP provided in March 2002. It was also recognised in the NAO report on OPRA published in November 2002, by an OPRA spokesperson in December 2002 and in OPRA publications issued in 2003. A GAD official also recognised this in a meeting in March 2000.

58. However, I note that in public – in, for example, parliamentary debates in March 1995 right through to as late as a December 2001 statement by OPRA – official sources sometimes appeared to suggest that shortfalls in non-pensioners’ rights would only occur – where a scheme was funded to the MFR level – if fraud had occurred.

59. Thus, on the one hand, it is clearly the case that public bodies knew at the time that financial loss on scheme wind-up would not be restricted to those in schemes which were either ‘under-funded’ on the MFR basis or which had been the subject of fraud or other unlawful activity.

60. On the other hand, the public assurances given by Government were that the MFR was designed to ensure that a scheme, if funded to that level, would have enough assets to meet its liabilities in full. Such assurances were given during parliamentary consideration of what became the Pensions Act 1995, in parliamentary answers to questions given in June 2000 and February 2001, and in a Westminster Hall debate in July 2001. In the former debates, assurances went further. It was stated that, even where a sponsoring employer became insolvent and was unable to make further contributions, funding to the MFR level would enable a scheme to meet all of its liabilities.

61. What, in the light of all of the above, could non-pensioners reasonably have expected from reading or hearing official sources of information about positions where their scheme was funded to 100% on the MFR basis? I consider that they would have expected in such circumstances to receive a cash transfer value calculated by an actuary that would reflect their full accrued pension rights.

**Did complainants have regard to official information?**

62. In relation to DWP’s submission that some of the leaflets about which I have concerns are long out-of-print and thus were irrelevant to the complaints I received in 2004, that seems to me to be a submission wholly without merit.

63. Complainants have told me that they took decisions – or refrained from action – some time before the winding-up of their scheme. Their complaints were directed at assurances in official publications that were provided some time before either the complainants’ schemes wound up or the injustices that they claim to have suffered had crystallised. Thus the official statements that they claim lulled them into a sense of ‘false security’ were precisely those which were available many months before their scheme wound up, and many of those publications may indeed be no longer in print.
64. As for why some of the official statements about which I had concerns did not feature in the original individual complaints or in Dr Altmann’s submissions in support of those complaints, it should be remembered that the description of the alleged deficiencies in official information that were set out in the statement of complaint for this investigation only gave examples and was not intended to be exhaustive.

65. Many of the complainants have sent me copies of old leaflets from their records and others have pointed me to contemporaneous press cuttings or original excerpts from *Hansard*. Indeed, in the case of some of those publications that are now out of print, it has largely been through the material sent to me by complainants that I have been able to establish what was in them.

66. I am satisfied that many complainants had regard either to the specific statements made by public bodies or had read scheme and other documentation which, I have seen, often replicated excerpts from official information.

*Would disclosure of risk have prevented injustice?*

67. Turning now to whether disclosure of risk would not have led to a similar – or greater – injustice, it seems to me that the Government’s submissions appear to assume that, had all members known the true risks, the only options open to them were to stay in or to leave their scheme.

68. However, I am not persuaded that this was necessarily the case. For example, had trustees had more and better information available to them, and assuming such information was absorbed and fully understood, it would have enabled greater understanding of the strength of the security offered by the MFR and of the background to and effect of the changes made to the MFR in 1998 and 2002.

69. In that context, trustees might have:

- attempted to seek higher levels of funding from sponsoring employers, in recognition that the MFR represented a funding benchmark that fell short of the monies that would be needed on discontinuance;
- attempted to seek even higher funding, as the costs of buying out benefits on discontinuance rose over time;
- disclosed the security issues to their members if they were unable to secure such extra funding;
- opted for a ‘gilts-matching’ investment strategy, to move to a stronger MFR calculation basis and hence maximise the MFR minimum employer contributions;
- opposed early retirements unless the employer provided sufficient additional funds to cover the annuity buy-out cost of the resulting pensioner liabilities, to avoid the ‘priority drift’ effect; or
70. If members had also had more information and absorbed and fully understood the level of security provided to their benefits by the MFR, they might have:

- pressured employers to raise contributions (in some cases employees arguably had a stronger negotiating hand than trustees in this respect, especially where strong and organised trades unions existed);
- elected not to transfer benefits from other pension arrangements into the scheme (if applicable);
- opted not to make additional voluntary contributions or otherwise spread their investments;
- retired from schemes sooner in order to secure their place higher up the winding-up priority order; or
- sought to take transfer values from schemes in financial distress (before reductions for under-funding were applied to transfer values).

71. Furthermore, there were also options available to sponsoring employers of pension funds that subsequently went into wind-up, had they understood more fully the level of security afforded by the MFR or had their employees put pressure on them to act. For example:

- some employers would have contributed more if the MFR had not been weakened, meaning less of a shortfall for the schemes where the sponsoring employer subsequently folded;
- for others in greater trouble, a stronger MFR would have hastened the pension fund wind-up (and in some cases the corporate insolvency), and limited the benefits that were exposed to being reduced;
- some employers would have taken remedial action sooner, which could have prevented pension fund wind ups – such as closing the scheme to new entrants, reducing future benefits, raising retirement ages, ceasing future accruals or cutting other business costs to enable higher pension contributions; and
- others would not have done deals that weakened employer covenant strength (or, conversely, may not have passed up opportunities to do corporate deals that could have enhanced the security of the pension fund). Some corporate restructurings that weakened pension funding or employer covenant strength might not have happened if all the parties had had a better appreciation of the true extent of the pension funding problems. Conversely, other
companies might not have turned down opportunities to sell a business to a ‘white knight’ that could have prevented the company failing because they thought that the pension scheme funding position was better than it really was.

72. It seems to me that the absence of clear, consistent, accurate and complete information from those who were responsible for the statutory basis for pension scheme funding led to ill-informed corporate decision-making by sponsors of pension funds that subsequently went into wind-up and equally ill-informed decisions taken by scheme trustees and members.

73. I recognise that it would not have been a straightforward decision for active members to leave their scheme and take a transfer value when, in many cases, such action might have resulted in them losing valuable death-in-service and ill-health retirement cover.

74. I also accept that the analysis done by GAD for DWP may well reflect a true position for certain people who chose to leave their scheme but found later that their scheme did not wind up with insufficient funds.

75. In my view, however, it is not enough to suggest that, had an individual known that their pension was at risk, they would still have suffered a financial loss because they necessarily would have transferred out of their scheme.

76. I consider that there were clear alternatives to such an action and, as a result of the maladministration I have identified, the individuals who have complained to me have been prevented from taking such action through having been misled as to the need to do so.

77. My general approach to resolving complaints that maladministration has caused injustice to individuals is, where maladministration has been identified, to seek to put those individuals back into the position they would have been in had that maladministration not occurred.

78. In this case, it seems to me that it is impossible to put those who have complained to me back into a position in which they had been properly informed as to the potential effects of the limitations of the relevant legislative provisions that aimed to protect their accrued pension rights.

79. As their scheme no longer exists, I also consider that it is far too late to seek to provide those individuals with an informed choice about their membership of it or about what else they could do to protect their position.

80. Those individuals have been prevented from being able to make those choices for themselves at the appropriate time. That is an injustice.
Annex D
The Government’s response to my report

Introduction
1. This annex sets out the response of DWP to my report. It includes a supplementary submission made by the Government Actuary to support DWP’s response.

2. The words used in this annex, insofar as they are italicised, are those of the authors. Inclusion in this report does not denote that I accept that all of what follows is an accurate reflection of the relevant facts.

Text of letter dated 27 January 2006 from the Permanent Secretary of DWP
3. I would like to say, at the very outset, that we greatly sympathise with those individuals whose schemes have been wound up and who have, as a consequence, lost a significant part of the occupational pension they had been led to expect by their scheme. However, as the Permanent Secretary, I must inevitably concentrate on the key issue of whether those losses were caused by any maladministration by my Department or resulted from other causes.

Findings
4. Having considered the report in considerable detail, I have to tell you that we are not able to accept your findings in respect of the actions taken by my Department for the reasons set out below.

5. There are a number of findings, to which I draw attention below, which the Department is unable to accept and considers to be flawed. But the most fundamental point is that, however great the sympathy one may feel for the individual complainants, the report, as drafted, provides no proper basis for concluding that the alleged maladministration, even if we were to accept that it had occurred, which we do not, would have had any material impact on the outcomes for those individuals.

6. Let me now turn to the major issues and findings of the report.

Information
7. Your report, in relation to official information, concludes that the information about the level of security provided by the MFR was sometimes not consistent, accurate or complete and, as such, was potentially misleading. It also says that the failure of the Department to review existing leaflets after we were told that people did not know the risks to their accrued rights was maladministrative.

8. We do not consider that the report substantiates these findings. Nor does it demonstrate (even if we were to accept these findings, which we do not) that all of the individual complainants read any of the supposedly misleading information.

9. Even if they did so the report does not demonstrate, in our view, that any of the complainants would have acted differently as a result of having done so.

10. We believe that the report also fails to consider adequately whether individual scheme members received, or should have received, information from their scheme’s trustees (informed as this would have been by advice they received from actuaries or other professional advisers).
11. In other words, it appears to assume that they had read and were guided solely, and were entitled to be guided solely, by the supposedly misleading information about the MFR, notwithstanding the duty on trustees to exercise reasonable care in handling their scheme’s affairs.

12. In terms of the information itself, we believe that the report fails to recognise that:

(i) while individual statements can be questioned, Ministers and others repeatedly stressed that the MFR was intended to provide ‘greater’ protection rather than any absolute guarantee;

(ii) it was repeatedly stressed that the MFR was intended as a balance between the interests of scheme members and employers; by its nature that implies that neither was getting absolute protection;

(iii) all of the leaflets to which the report refers carried a general health warning making clear that they were not complete explanations of the law and were for general guidance only. As such they could not be absolutely relied upon; and

(iv) the advice in a number of the leaflets, that most members of an occupational pension scheme would be better off when they retire than they would be if they did not join it, was accurate.

13. In terms of whether any individual complainants read the disputed information, we note that less than half of the respondents to your survey said that they had seen the publications in question.

14. Even more importantly the report offers no substantial evidence that, even where they did so, they acted differently from how they would otherwise have acted because they read these publications. Given the wide range of sources of information available to the complainants, and the very general nature of the Departmental publications, it is unlikely in the extreme that these publications would have materially influenced their actions.

15. Furthermore the report appears to rest on the assumption that, even where an individual read the information and did act differently as a result, they were entitled to rely on it as a justification for doing so. In this respect it is quite clear that the primary responsibility for safeguarding the interests of scheme members, and communicating accurately with them, rests with the scheme trustees.

16. Indeed, since April 1997 it has been a legal requirement that all of the defined benefit schemes under consideration in the report must appoint an actuary. Even if individual scheme members might not have understood the limitations of the MFR, the actuarial profession most certainly did.

17. Moreover, each MFR valuation certificate carried a statement that meeting the MFR did not mean that, in the event of the scheme’s winding up, full benefits could be secured.
18. It seems to us to follow from this that no scheme member, properly guided by their scheme trustees, in turn properly advised by the scheme’s actuary, should have been in doubt about the actual level of protection offered by the MFR.

19. Finally, in this regard, we are advised that statements made by Ministers to Parliament during the passage of a Bill are not statements made in exercise of an administrative function. Ministers, in explaining and debating the 1995 Pensions Bill, were participating in the legislative process and so exercising a legislative function.

20. Consequently we do not think you have the powers to investigate such statements, and so, to the extent that any findings of maladministration are based on such statements, we believe that they should be disregarded.

21. Similarly, since it is... outside of your jurisdiction, we do not think you should include, or rely upon, any information given by the Financial Services Authority in reaching your conclusions in this respect.

The 2002 decision to amend the MFR

22. Turning now to your third finding of maladministration in respect of the 2002 decision to amend the MFR, we similarly do not consider that the report substantiates a finding of maladministration.

23. [The annex] to this letter [which is below] sets out a number of detailed considerations which we have taken into account in reaching that conclusion.

24. More generally, however, as the report acknowledges, it is clear that the MFR is a subject of very considerable complexity. Accordingly, the technical detail for calculating the actuarial basis of the MFR was set out in a guidance note (GN27) prepared and issued by the actuarial profession after approval by the Secretary of State.

25. The actuarial profession also then kept the actuarial basis of the MFR under continual review and recommended to the Government such changes as they considered appropriate to keep the strength of the MFR in line with the level of the original policy intention.

26. It is clear that the recommendations given to the Department in respect of the 2002 decision represented the considered view of the profession as a whole at that time; the recommendations were informed by extensive analysis by the Technical Support and Research Committee of the Pensions Board of the actuarial profession which, at that time, contained a number of the leading technical actuaries from all of the major firms of actuaries.

27. The formal approval of the recommendation was the responsibility of the Pensions Board, whose membership also encompassed the major actuarial firms. The Department was also guided... by the advice of its own professional advisers in the Government Actuary’s Department.

28. Against this background, we simply do not understand how a finding of maladministration can be justified. The Department acted on the advice of the actuarial profession, which had been confirmed by the Government Actuary’s Department. Even if, which we very much doubt, a
different decision, going against the professional advice, might properly have been taken in those circumstances, we cannot see how a decision to follow such professional advice (from two independent sources) can possibly be considered to amount to maladministration.

29. Indeed we consider that it would have left the Department open to very substantial criticism and risk of challenge not to have accepted the profession’s recommendation in these circumstances without good reason.

Issues of scope and timing

30. You have decided that the coverage of your recommendations should begin with members of schemes that wound up after 6 April 1997... But this decision ignores the issue of relating the alleged maladministrative documents to the individuals who have lost financially.

31. Even if we accepted that individuals were misled by Departmental publications, which for the reasons set out above we do not, they cannot by definition have been misled by a leaflet that was produced after their scheme had begun to wind-up.

32. The only allegedly maladministrative document in circulation in April 1997 was the PEC3.

33. It surely follows, therefore, that the coverage of your recommendations should be limited to individuals who had read the leaflets the report characterises as maladministrative. These considerations do not appear to have been taken into account.

34. A similar issue arises in respect of whether schemes were in fact funded to the MFR level. The report says that it was thought that, if a scheme was funded up to the MFR, any accrued rights were safe.

35. Even if we accepted this proposition, which for the reasons set out above we do not, it must follow that members of schemes which were not funded to the level of the MFR could not have had such an expectation and, therefore, that their losses cannot be attributed to any alleged maladministration.

36. The report refers to only two of the four schemes of which the representative complainants were members as having been funded up to the MFR.

37. By definition, a scheme that was not funded up to the MFR could not have been thought by its members to have satisfied this requirement, whatever protection they may have thought this offered.

38. I am afraid we simply do not regard as remotely plausible the argument [set out in annex 3 to this report] that a member of a scheme underfunded against the MFR could have drawn the inference that, if the MFR offered full protection, those who were not funded up to the MFR could expect proportionate protection.

39. Even if (which we very much doubt) any complainants did draw such an inference, they would have had no basis whatsoever for doing so. In addition, at least some of the schemes that wound up would not even have had an MFR valuation, as the MFR was phased in over three years in line with schemes’ normal valuation cycles.
Similarly in respect of your finding of alleged maladministration in respect of the 2002 decision to amend the MFR calculation, that, self-evidently, cannot have had any impact on schemes that wound up before March 2002, or that had the employer debt certified before that point. Indeed, unless an insolvent employer’s scheme had reached the end of its valuation cycle between 2002 and wind-up, the employer would still (prior to insolvency) have been required to pay contributions based on the previous “stronger” (in your terms) level of the MFR.

Causal link

We do not find that the necessary causal link has been demonstrated between the maladministration, which we do not in any event accept, alleged in this [report] and the losses incurred by the complainants.

The report does not show that, but for having been misled by the alleged maladministration, the complainants would have taken steps to protect their accrued rights and that this action would have been effective in preventing the losses.

The examples [you have] given of actions that could have been taken to avoid or reduce the losses are unconvincing. The report says that the alleged maladministration was a significant contributory factor in causing the financial losses. However, it offers no substantive reasoning to back up this statement. In summary, the report does not acknowledge the myriad uncertainties which attach to any consideration of how outcomes might have differed if the specific actions criticised had been undertaken differently.

Given the number of causal factors at work, the vast majority of which fall wholly outside the scope of the present jurisdiction (and indeed wholly outside the Government’s control), the Department would suggest that the only rational conclusion is that the matters criticised, even if (which we do not accept) such criticisms were justified, are unlikely to have made any difference to the outcomes for the individual complainants.

Recommendations

We would also wish to comment on the specific recommendations in the report. The well-established standard applied by Ombudsmen (endorsed by the Government and the Public Administration Select Committee) is that a person should be put back into the position he would have been in had the maladministration not taken place. Given that, as noted above, the report does not indicate what part, in your opinion, the alleged maladministration played in the losses incurred by the complainants or what could be done to correct it, we are unable to consider this issue.

You have also asked us to consider whether it is appropriate to use taxpayers’ money to pay for losses which are not the responsibility of this Department and which arose from the actions of others. We would of course expect a strong evidence base to justify incurring such expenditure.

The report provides no such base. It would be especially difficult to justify such a decision insofar as the recommendations in your report take account of issues which, I am advised, go beyond the powers given to you under the Parliamentary Commissioner Act.
You have offered the Department a further two months... after publication to respond to your recommendations and we were grateful for your consideration in doing so.

However, given that, on the basis of the report as drafted, we are minded not to accept your findings of maladministration, we believe that any delay in responding to the recommendations could only serve to raise false hopes amongst the complainants concerned.

We therefore need to inform you now that... we are not minded to accept the first four recommendations in your report.

We are minded to accept your fifth recommendation – to review the time taken to wind-up final salary schemes – and indeed have already set some work in hand on this; although we need to recognise that the delays are largely outside the control of Government.

Other issues

You refer in the report to the Financial Assistance Scheme... We acknowledge your view that the FAS does not provide full compensation – nor was it intended to do so. Nevertheless, the FAS will provide, in our view, a significant measure of help to some of the worst affected individuals.

The Government has made it clear that it will review the FAS in the forthcoming Comprehensive Spending Review and, whilst it does not accept liability for individuals’ losses, it will take account of the issues raised and the individual experiences highlighted in your report when carrying out this review.

Finally, I would like to stress again the point made [at the beginning] of this letter.

No one reading the opening paragraphs of Chapter 2 of your report can fail to have enormous sympathy with the predicament of many of those individuals who have complained to you.

But that, I am afraid, can not absolve us of the responsibility to respond to your report and its recommendations on their merits, particularly in considering whether any liability for the events attaches to my Department.

Having done so, we are firmly of the conclusion that your report does not substantiate any maladministration on the part of my Department.

The 2002 reform of the Minimum Funding Requirement (MFR)

Your report makes frequent reference to “weakening” and “strengthening” the basis of the MFR.

Lest there be any misunderstanding on this point, it is worth saying again that the adjustments to the MFR were always on the principle of maintaining its April 1997 level.

This was the principle on which the actuarial profession kept the basis of the MFR under review and made recommendations to the Department. It was also the basis on which the Government Actuary’s Department (GAD) advised the Department.

During the second half of 2001, the Department had regular meetings with the representatives of the Pensions Board of the actuarial profession on a range of matters of mutual interest, the
most significant being the abolition of the MFR and the package of interim changes pending abolition then being developed.

62. At a meeting between DWP and the profession on 9 July 2001, the profession indicated that it expected to write to DWP about the MFR basis, recommending a 0.25 percentage point reduction in the benchmark dividend yield used in calculating the equity market value adjustment (MVA).

63. A further meeting took place on 4 September 2001, the day before the profession wrote to the Department, at which the Pensions Board confirmed that it would be writing to DWP in the next few days to recommend a reduction in the dividend yield from 3.25 per cent to 3 per cent.

64. This demonstrates that the 5 September 2001 letter was expected; both the Department and its advisors from GAD were aware that there was support for the change to the dividend yield in the MVA and the reasons why it was being proposed.

65. This was borne out by subsequent responses to the DWP consultation initiated in September 2001, the profession having informed all actuaries of the proposal that it had made to my Department (as indicated in their letter of 5 September 2001).

66. The Department was conscious that any change would need to be considered in the context of the detailed interim changes proposed by the profession in May 2000.

67. The net effect of the changes proposed in May 2000 had been small... Paragraph 5 of Annex C to the September 2000 consultation document “Security for Occupational Pensions” sets out the overall effect.

68. Consultation on those changes revealed little support for them, particularly if the MFR was to be replaced in the near future. Implementing all three proposed changes would have required schemes and their advisors to have made complex adjustments to their systems.

69. In their letter of 5 September 2001, the profession made clear that they considered that changes in the economic circumstances since their recommendation of May 2000 did now warrant making a change and that they were recommending a single change to the dividend yield in the equity MVA to keep the change as simple as possible in the light of the Government’s announced intention to abolish the MFR.

70. Nonetheless, the profession made clear that their proposed change from 3.25% to 3% in the dividend yield in the MVA was to take account of two factors – further reductions in dividend yields since the May 2000 recommendations had been made, together with a change to the mortality assumption.

71. Although not quantified in the letter from the profession, the change to the mortality assumption would have been in the region of an increase of some 9% for non-pensioner members more than 10 years away from scheme pension age.

72. The profession said in their letter that, if a separate change had been made for mortality, they would have proposed a greater reduction in the benchmark dividend yield from 3.25% to 2.75%.
The change to 3% was to take account of both factors whilst keeping the change simple for schemes to administer until the MFR was replaced.

73. Thus, the recommendation made in September 2001 was not inconsistent with the recommendation made in May 2000, as you say in... [your] report.

74. The recommendation was still based on improved longevity and falling dividend yields. But, whereas in May 2000 the overall effect of these two factors was to cause the MFR to be operating at a lower level than when it was introduced, by September 2001 the overall effect was to cause the MFR to be operating at a higher level because dividend yields had fallen further since May 2000.

75. The Department believes that inferences are being drawn from the precise wording of the GAD advice... that are not warranted by the context.

76. The Department does not read the reference in that advice to events since 11 September 2001 – which is understandable in all the then circumstances – as limiting the scope of that advice.

77. The advice given in the email of 25 September 2001 was in confirmation of earlier discussions and so not the only component of the advice given to the Department on a recommendation which had been anticipated. That advice would have been informed by the access which GAD had, through its involvement in professional affairs, to the detailed work carried out by the Technical Support and Research Committee of the Pensions Board of the actuarial profession. In addition it was certainly open to GAD to raise any further issues that they thought were relevant.

78. The Department received no representations to the effect that this recommendation – made public by the profession after it was submitted to the Government – was unreasonable. Indeed, the representations received were in support of the change.

79. In the light of these facts, the Department cannot agree that it did not give proper consideration to the issue.

**Official Information**

**Maladministration**

80. There is, of course, always room for improvement in the presentation and management of official information. The Department takes its role of producing leaflets and information for the public very seriously.

81. However a balance inevitably needs to be struck between the information needs of the range of readers.

82. A recent report by the National Audit Office has provided a useful basis for the Department to make improvements in a number of places.
83. Areas the Department is treating as a priority for improvement are:

- the consistent application of standards for all the Department’s information products, which we plan to take forward by centrally monitoring our information output for consistency and accuracy;

- an increase in staff awareness of their obligation to provide accurate and up to date information to the public (be that verbally or in writing); [and]

- better management of the risks associated with our information output by examining leaflets individually as well as collectively.

84. But, notwithstanding the need for continuous improvement, publications cannot be regarded as maladministrative simply because they fall below the standards set down in internal guidance.

85. Indeed, such a judgement could of course be counter-productive, deterring Departments from issuing such guidance in the first place lest they should ever fall short of their own standards.

86. It is not clear that a judgement has been made as to whether or not the alleged failings identified fell so far short of acceptable standards and were of sufficient seriousness as to warrant being considered maladministrative.

87. In particular, it cannot be maladministrative simply for the Department to have taken a decision, with regard to what should be covered in a leaflet, that was different from the assessment which the Ombudsman would have made: two reasonable people can make different decisions based on the same evidence.

Outrage and distress
88. No one would wish to minimise the feelings of the complainants which are extremely understandable.

89. However, the report fails to examine whether these quite natural feelings are properly directed towards the Government, or whether they are a consequence of the alleged maladministration. The amount of funds left in the scheme at the point of wind-up (which is the cause of the losses) was the outcome of investment decisions made by trustees, the level of contribution from both the employer and the employee set by either the employer or the trustees and the sharp fall in the stock market.

90. None of these involved the Department. While the DWP did decide to issue information on occupational pensions generally, it did not assume any responsibility for advising individual complainants on their pension options.

Offsetting action
91. Suggestions that different official information on scheme security in general could, for instance, have led sponsoring employers “...to make additional arrangements – perhaps through merger with other businesses or by attracting new capital – to enable them to increase the contributions to their schemes.” are wholly speculative.
92. The report considers that, had the members of schemes been warned about the possible consequences to accrued rights, should their scheme wind-up, that “many of their financial decisions would unquestionably have been different”.

93. However there appears to be nothing in this report to support that contention. Those changing employers might have decided to leave their accrued rights where they were. But this does not mean they would have done so, nor that this would have offered them greater protection. What if their old scheme wound-up but their new one did not? There appears to be no evidence for saying, as the report does, that those who had money to make additional pension provision “would most probably have chosen not to make additional voluntary contributions”.

94. Furthermore, ... a person might have taken other actions, such as putting the value of their accrued rights into a badly performing personal pension, which could have left them in a worse position than they currently find themselves in. This possibility does not appear to have been considered.

**Supplementary submission by the Government Actuary**

95. I also received a letter from the Government Actuary, the text of which follows.

96. My comments on the report... relate to the section dealing with the 2002 changes to the MFR, which is the only part of the draft report which refers substantively to the role of the Government Actuary’s Department (GAD).

97. Our response has been co-ordinated with that from the Permanent Secretary of the Department for Work and Pensions (DWP).

98. Accordingly, we have not duplicated points made in that response, although we have sought to amplify certain points where we considered that would be helpful to you.

99. There is considerable discussion in the report as to whether security was made less or more for scheme members as a result of changes to the Minimum Funding Requirement (MFR).

100. However, it has not been demonstrated that the change in the level of security afforded was material.

101. Changes to the MFR were intended to provide incentives to schemes to improve their funding levels, although these changes could not achieve this immediately.

102. 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.

103. Under the MFR process, schemes were required to bring their funding up to the revised level, but this would only happen gradually. In the short term there would be no material improvement in the security afforded to members unless the employer chose to wind up the scheme and the funding of the scheme, on wind-up, fell short of the strengthened MFR level, triggering a debt payment from a solvent employer to the scheme. Where wind-up was triggered by employer insolvency, it is unlikely that any strengthening of the MFR would have had a material impact,
given that any employer debt payments due to the pension scheme did not have preferential creditor status.

104. There certainly were reasons at the time of the May 2000 recommendations to strengthen the MFR basis, notably because of the need to recognise improving mortality. However, there were also reasons to adjust the equity MVA calculation to avoid the unintended strengthening of the MFR that had taken place as a result of changing market conditions.

105. Overall the increase in MFR liabilities required was not large... the changes proposed at that time were expected to worsen the funding level of typical schemes against the MFR by up to 5%. This was not a big increase, and, bearing in mind that changing the MFR would not automatically make schemes better funded, and that longer term changes to the MFR were then being discussed, it was entirely reasonable for DWP to decide not to make any short-term change at that time and their decision-making process to arrive at this conclusion could not be considered to have been in any sense maladministrative.

106. As the impact of the changes to the economic and investment factors in the MFR formula grew, they began to overwhelm the effect of the mortality changes needed. So, what was now needed was an aggregate weakening of the basis, if the original strength of the MFR was to be maintained in absolute terms relative to the position when the MFR was first put in place in 1997. As we understand the position, it was not the intention, either of DWP or of the actuarial profession, to seek to maintain the strength of the MFR relative to an insurance company buy-out basis.

107. The profession then combined their advice into a lesser reduction in the equity MVA factor (3.25% down to 3.0%, instead of the 2.75% that they considered justifiable, had an appropriate change been made to the mortality assumption at the same time). The September 2001 recommendation from the profession brought together mortality and economic developments into one adjustment to the equity MVA, so the necessary strengthening as a result of mortality was included, even though the aggregate change was to reduce MFR liabilities.

108. The statement made [in paragraph 5.129] fails to recognise that GAD had been aware of, and closely involved in, the development of the profession's thinking on the MFR over many months and so GAD was fully aware of the context and scope of the profession's work when the Department's request for advice was put to us in September 2001. Furthermore our e-mail of 25 September 2001 was in confirmation of earlier discussions with DWP and so not the only component of our advice. Nor was our advice limited in any way, and particularly not in the way suggested [in paragraph 5.130]. The context of that advice was the overall question of how the strength of the MFR basis might have changed since it was last reviewed.

109. We do not agree that our advice was limited in the way suggested [in your report]. Neither do we agree that we failed to answer the question that DWP had put to us. This is a completely distorted interpretation of the GAD advice, exemplified by the unacceptable description of one paragraph of that advice as being the “full advice”.

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110. The statement made [in paragraph 5.138] does not recognise that, through its involvement in professional affairs, GAD had had access to the detailed work carried out by the Technical Support and Research Committee of the Pensions Board of the actuarial profession, the committee that undertook the analysis leading to the profession’s 5 September 2001 recommendation.

111. Once again, [paragraph 5.142] does not recognise the context of continuing discussions on the replacement of the MFR, involving GAD, the Department and the actuarial profession, over the period between September 2001 and January 2002.

112. [Your] report asserts that DWP was aware that the change would have the effect of significantly weakening the protection being offered. However, we understand that the DWP (and the actuarial profession) did not believe at the time that it was weakening the protection compared to that which the Pensions Act 1995 had intended to provide, merely restoring it to the original, 1997, level.

113. Furthermore, it was not a “significant” change; as the parliamentary question [you have referred to...] notes, the immediate effect of the change was to increase aggregate funding when measured on the MFR basis by around 3 per cent.

114. As explained... above, changes to the MFR did not have an immediate effect on levels of funding except in the limited circumstances where a scheme wound up and the employer was in a position to make up any funding shortfall to the level of the MFR.

115. Moreover... the evidence base [for DWP’s decision] was not insufficient since it was based on strong advice from the actuarial profession, which had been developed by a committee containing leading technical experts from most of the major firms of actuaries, and supplemented by GAD as a further independent source of advice. The evidence base for this decision was in fact extremely strong and much stronger than for many (probably most) of the decisions that have to be taken by Government.
Annex E
The response to my report from the advocate for complainants

Introduction
1. This annex sets out the response to my report provided by Dr Ros Altmann, on behalf of complainants.

2. She told me that:

   On behalf of complainants, I welcome this report, but with great sadness that many of those affected did not live to read it. It has been several years since the victims of this huge social injustice first discovered that they had lost most or all of the company pension they had contributed to and which they had been led to believe was safe and protected by law. The experience of losing one’s entire retirement income and the uncertainty hanging over these individuals and their families is impossible to over-estimate. Their sense of betrayal is acute.

3. Dr Altmann continued:

   At last, an independent investigation has highlighted clearly, for all to see, the gravity of the injustice that they have suffered. Having been brushed aside and fobbed off by Government for so long, the complainants had almost lost faith in justice and the rule of law. It is comforting, therefore, to see that our Parliamentary democracy does have a mechanism for forcing Governments to face the consequences of their actions, where Ministers and officials are unable themselves to appreciate the injustices they are responsible for.

4. She told me that:

   ... it is an important principle that, if Government makes mistakes that lead to grave injustice, it should rectify those mistakes rapidly, rather than trying to force the victims into accepting their losses. Surely, when officials claim that they want to make sure people can save in a safe environment, the public is entitled to look to the Government to protect their interests, rather than giving higher priority to the interests of powerful lobby groups such as employers?

5. Dr Altmann continued:

   This has been an exhausting, frustrating and deeply depressing fight – and many lives have been destroyed. I have watched people die, desperate because they had tried to provide for their families; they had believed and trusted in the system and then found that their trust was misplaced. Having saved all their lives to look after themselves, they could not bear the thought that they had unwittingly “let their loved ones down”. These stories are a dreadful indictment of our pension system and I hope the fight for justice in this instance may ensure that others, in future, will not suffer in the same way. If something is not safe, the Government should not tell us that it is. If Government assurances of safety turn out to be false – due to unforeseen circumstances – then it must quickly compensate those who have been damaged.
6. She concluded by saying:

It is heartening that the Parliamentary Ombudsman has uncovered the full extent of this injustice, and I hope that all Members of Parliament will recognise immediately that they have a duty to ensure that full restoration of pensions is forthcoming straight away. These people have suffered more than enough – it is time they received a full apology and full restoration of what has been lawfully taken away from them and what they were always told was actually “protected” by the law.

7. In addition to these general comments, Dr Altmann made specific comments about four aspects of my report: on my findings on maladministration; on my findings on injustice; on my recommendations and the Financial Assistance Scheme; and on the Government’s response to my report.

Findings – maladministration

8. Dr Altmann told me that the evidence set out in my report demonstrated clearly that the complaints made by scheme members and trustees had been justified. Government had been responsible for the establishment and design of the MFR and for the legal framework within which occupational pensions were provided but Government bodies had not properly informed citizens of the level of security that was provided by that framework.

9. She said that my report made clear that the then Government had decided in November 1995 that non-pensioner scheme members would only have an even chance of receiving their pensions. And yet the Government had for many years told everyone that their pensions were safe, guaranteed and protected by laws.

10. She said that it was astonishing that official publications had only dealt with scheme wind-up for the first time in April 2004 – this constituted ‘a huge betrayal of trust’. Many scheme members had told her that they had been shocked to discover that the Government had failed to tell them the truth about the security of their pensions. One had asked her ‘if you can’t trust the Government, who can you trust?’ She said that the evidence set out in my report confirmed this ‘betrayal’.

11. Furthermore, Dr Altmann told me that she did not understand how Government could have felt it was acceptable to design and operate a system that would only provide a 50% chance of protection to non-pensioner scheme members. She asked whether it would be considered acceptable if the Government ‘had encouraged people to put their money into a bank and told them it was safe, without warning them that they had only a 50% chance of getting it back’. Or, indeed, ‘whether MPs and civil servants would consider it acceptable if they were not told that they had only a 50% chance of getting their pensions?’

12. Dr Altmann told me that it was clear from the evidence that Government had deliberately decided to encourage pension scheme membership – and that such a policy had driven their agenda of informing the public of the benefits of joining.

13. However, at the same time, she said that my report showed that that policy also determined the omission of any warnings about the risks to pension rights. It appeared that Government
had decided that it would damage their aim of increased private pension provision if official publications aimed at the public were to deal with risk at all. In her view that was ‘dishonest and irresponsible’ – and did not accord with any reasonable standard for the proper discharge of public functions.

14. Dr Altmann told me that the evidence in my report also clearly showed that the Government had been consistently more concerned for the interests of employers than ensuring an adequate degree of member security. This was evident from the decisions taken on the MFR basis and on the other decisions taken by Government on related matters, including in relation to the extension of deficit correction periods.

15. Dr Altmann pointed out that the law had allowed solvent employers, who could well afford more, to ‘walk away from their pension liabilities’ without having to ensure that the pensions of their scheme members were paid in full.

16. She told me that the evidence disclosed by my investigation suggested that the decisions relating to changing the MFR basis had been taken by Government without due regard to the possibility of solvent employers choosing to wind up their scheme and without paying attention to the decreasing number of suppliers and increasing costs of bulk annuities.

17. Dr Altmann said that there was no evidence that the Government had considered the risks to members of solvent employer scheme wind ups – their discussions on the MFR had clearly focused on the risks of employer insolvency.

18. Nor had any evidence been found to suggest that, when changing the MFR, the Government had considered the fact that security for non-pensioner benefits and Guaranteed Minimum Pensions would be dramatically reduced – as the rising costs of annuities necessarily meant that far more of the fund assets would be needed to secure pensioner benefits, leaving much less for non-pensioners.

19. She told me that all of the above pointed to a comprehensive failure by Government to ensure that its policies were properly explained, that its actions were taken in a transparent manner, and that the reality of the ‘pensions promise’ and associated risks were disclosed clearly to people to enable them to make informed choices and to protect their financial future and that of their families.

20. Dr Altmann said that all of the above demonstrably constituted maladministration of a most significant and far-reaching kind and that my report set this out clearly.

Findings – injustice

21. Dr Altmann told me that my report had identified a number of contextual factors that helped to explain the circumstances in which schemes had wound up without sufficient assets to meet their liabilities to all members.

22. She said, however, that it should also be properly recognised that this injustice was further compounded by the legal requirement that schemes in such a position have to discharge their
liabilities through the purchase of annuities. Only Government could remove this requirement, thereby enabling schemes to use the assets of the scheme for the benefit of all its members.

23. In addition, Dr Altmann said that one other aspect of the legal framework had further added to the injustice suffered by scheme members – the requirement that individuals who were members of a final salary scheme could only contribute to one pension at a time. In such a context, she told me that the Government had restricted the freedom to diversify investment that might have enabled scheme members to protect their position. This meant that the protection provided by the framework devised by Government was all the more important to individuals and that it should both have been robust and properly explained to scheme members. Where, as here, such protection failed, the Government had a responsibility to remedy the injustice caused by such failures.

24. Furthermore, she told me that it was incorrect for Government to state that it had not given individual financial advice through its official publications. By endorsing membership of an occupational pension scheme, particularly in a situation in which the law for which it was responsible did not allow individuals to join more than one pension scheme, the Government was effectively giving citizens advice as to the benefits of joining one particular scheme. If they had only one employer, that constituted advice to join that one scheme. Had official information dealt with both benefits and risk in a proper and balanced manner, individuals would have been better able to assess their options and to make informed decisions about joining, about remaining in, about transferring money in from another scheme, and about when to take their pension. She said that my report made this extremely clear.

25. Dr Altmann also told me that it should be recognised that the legislation governing the MFR meant that it was perfectly legal for schemes to be funded well below the MFR level so long as a plan for the restoration of the funding position – over many years – was in place.

26. She told me that, in the light of all of the above, the Government must recognise that it was responsible for the injustice suffered by complainants that my report had identified. Not only did its failure to provide clear, accurate, complete and consistent information to scheme members constitute maladministration causing injustice to them, but Government could not evade responsibility for the other factors set out in my report.

27. In particular, Dr Altmann said:

(i) that, ‘whatever some sponsoring employers had done, it was the law created and operated by Government which both had allowed solvent employers to fund only to levels that would not secure the pensions of non-pensioner members and had also meant that debts owed to pension schemes by insolvent employers were not accorded priority when their assets were distributed’;

(ii) that other aspects of the legal, regulatory and administrative frameworks that my report set out were the direct responsibility of Government;
(iii) that ‘Government policy was directly relevant to the injustice suffered by scheme members — it may have been entitled to take those policy decisions but Government still had to face up to their consequences’; and

(iv) that the deficiencies in the system of winding-up schemes, which exacerbated injustice, took place within a system that had been designed by Government and for which it also had to take some responsibility.

28. Thus, she said, the Government’s actions and inaction were the direct cause of the injustice caused to scheme members and trustees.

Recommendations

29. Dr Altmann told me that she welcomed my recommendations. She said that primarily it should be recognised by Government — and by Parliament — that a sense of urgency was required in ensuring that Government responded positively to my recommendations and that they put right the injustice my report had identified.

30. She also said that it would be wholly unacceptable for there to be further procrastination and delay on the part of Government, as many individuals were in desperate financial straits and needed money now.

31. In addition, Dr Altmann told me that, while only Government could co-ordinate and organise this, there were ways in which the cost to the taxpayer of pension replacement could be mitigated. She said:

   In November 2003, I recommended that the assets of these schemes should not be used to purchase annuities, but that the schemes could be run on, allowing trustees to pay out pensions as they became due and then Government could set aside funding to top up the scheme assets in a pooled vehicle, which would be able to pay the pensions over the long-term. I proposed this again when the Financial Assistance Scheme details were announced and I have consistently asked the DWP to tell trustees to put the annuity purchases on hold, rather than allowing the scheme assets to disappear and making the organisation of compensation far more difficult.

32. She continued:

   The assets of all schemes in wind-up should not have been used for buying annuities. They should be pooled, with scheme pension records transferred by the independent trustees to a Government-funded body which could handle all scheme liabilities as if the schemes were still ongoing. The requirement is for pensions to be paid and these are long-term annual commitments. The only capital sums needed would be tax free lump sums for each member reaching retirement age immediately, and life assurance or ill-health benefits may need to be paid from time to time, but the rest of the liabilities can be paid over many years and would not require payments to be capitalised up front.
33. Dr Altmann told me:

*I fear that many schemes are very close to buying annuities, or have recently done so, and this will ultimately mean that the bill for taxpayers to fund compensation will be much larger than would otherwise have been the case. I suggest that the Government in response to this report should do the following:*

- stop schemes from buying annuities – as is seen in the report, Government recognised as long ago as its Regulatory Impact Assessment of the 2002 MFR changes that buying annuities is not necessarily the most appropriate way for younger members’ pensions to be secured;
- pool all scheme assets that have not already been used for annuities into a fund to run as a satellite of the Pension Protection Fund, utilising the systems and infrastructure which is already being put in place to pay out pensions for schemes in wind-up. This could be funded with top-ups from Government funds as required;
- permit scheme trustees to pay all pensions to those eligible now, including those who are terminally ill. These pensions could be paid in full to all those eligible, using the scheme assets which are available;
- use unallocated funds in the DWP budget, which could be dedicated to paying out compensation; and
- use unclaimed assets to fund the compensation payments required. Since banks often had priority over pension funds when companies became insolvent, there could be said to be a rationale for using these assets to fund compensation payments for scheme wind-ups.

34. Finally, Dr Altmann said that some scheme members had suffered financial injustice beyond that directly related to the loss of their pension and associated benefits.

35. She told me:

... some members have had to sell their houses since they were relying on the pension lump sum to pay off their mortgage, or some need to sell to replace their lost pension income and downsize their house. Others have suffered dreadful effects on their health. I hope that these factors can be recognised within redress provided by Government.

**Financial Assistance Scheme**

36. Dr Altmann said that her response to my recommendations had been informed by her strong view that the Financial Assistance Scheme was a wholly inappropriate remedy for the injustice suffered by complainants.

37. She told me that there was a good case for arguing that the way in which the Financial Assistance Scheme had been established and its eligibility criteria had been developed and announced in itself constituted maladministration.
38. Dr Altmann told me that:

The only payments being made are ‘interim’ payments of just 60% and these are still not paid if this amounts to under £10 per week. The other exclusions and rules are grossly unfair.

39. She continued:

In fact, the FAS itself is directly responsible for many members getting even lower pensions. This is because the costs of providing the FAS with data on scheme membership and details of those who may be eligible are paid out of scheme assets. This reduces assets for all members, but only a few actually qualify for the FAS. Thus, all those who do not qualify must end up with lower pensions as a result of helping those within 3 years of pension age. This is a further injustice.

**Government’s response**

40. Dr Altmann told me that she was extremely disappointed and distressed by the Government’s initial response to my findings.

41. She said that it was disturbing that Government still did not realise or accept the degree to which it had played such a central role in the events set out in my report.

42. Dr Altmann told me:

If the Government thinks that encouraging membership and failing to warn of risks is fine, and cannot see the error of its ways, then how can we hope for improvements in future? If any private sector firm or organisation behaved in this way, it would be forced to compensate in full for any losses.

43. She also said:

The report makes clear that, after ‘Maxwell’ and the pensions mis-selling scandal, the Government said that people needed to know where to get advice they could trust. The official leaflets were supposed to provide that. Given what had happened, if an individual at that time had been worried about their pension after ‘Maxwell’, people would not have necessarily trusted their employer or the trustees. In addition, if they had been worried about pension mis-selling, they would not have trusted financial advisers.

It is in this context that it was even more likely that they would rely on the Government’s information. It is also all the more disappointing that DWP is trying to suggest that people should not have expected to be able to rely on these leaflets! Why was taxpayers’ money spent on them if they were not reliable?

44. She told me that the Government’s further response to the report was totally unsatisfactory. She described it as ‘outrageous’:

Every right-thinking person with a sense of fairness and natural justice, when reading the evidence uncovered by this investigation, cannot fail to appreciate that what the Government has done to these individuals is wrong.
The real worry is that Government itself, in its response to the report, seems to be trying to deny the evidence clearly put before it.

It is Government that seems not to have told the truth, but it is also apparently now attempting to question what scheme members have said about having read and relied on the official leaflets.

This behaviour is adding insult to injury. These individuals have done nothing wrong.

Their lives have been devastated by the carelessness of Government. Their mistake was that they genuinely believed that Government would tell them the truth and it beggars belief that Government appears to be now saying that the scheme members either have lied about relying on the official materials that they read or that, if they did read them, “of course they should never have believed it”!

Since I first met the members of ASW Cardiff, in 2002, and subsequently having met so many other individuals who have suffered so much these past years, I have been struck by how decent and honest they are.

They believed and trusted in official assurances of safety and are the kind of people who are the bedrock of our British nation. Hard-working people who always wanted to look after themselves, worked and saved hard, tried to check out what they should do, and did what they thought was the right thing to do because Government told them so. We as a nation should be ashamed of how our Government is behaving on this issue.

Government seems to be trying to say that this situation is the fault of everyone else, but not itself. This is a mess that the Government itself has created and which it has consistently refused to acknowledge.

These are people who believe it is wrong to lie and have lived their lives by the principles of personal responsibility and honesty. Many of them still find it almost impossible to believe that Government could really behave dishonestly.

My assessment of Dr Altmann’s response

45. I will comment only on one aspect of the response of Dr Altmann to my report on behalf of complainants – that related to additional financial or other losses that would not be remedied by pension replacement.

46. DWP operates a scheme to provide redress for financial loss and other injustice caused by maladministration for which it or its agencies are responsible. Where an individual claims to have suffered particular financial loss because of maladministration by DWP, it is open to that individual to seek redress through that scheme. Evidence that certain actions were taken will need to be provided – as will evidence of the loss claimed.

47. If an individual is dissatisfied by the outcome of their claim to DWP in such circumstances, it is open to them to ask their Member of Parliament to refer their complaint to me. Such a complaint would then be assessed in the normal way by my Office and treated on its merits.