

A report by the Parliamentary Ombudsman of an investigation of a complaint about the Pensions Regulator.

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Contents

Foreword.....	5
Report by the Parliamentary Ombudsman of the results of an investigation of a complaint about the Pensions Regulator made by Mr L and referred by Graham Stuart MP.....	7
The complaint	7
The decision	7
The Parliamentary Ombudsman’s jurisdiction and role	7
Basis for the Ombudsman’s determination of the complaint	8
The <i>Ombudsman’s Principles</i>	8
The remit of the Pensions Regulator.....	9
Legislative and administrative background.....	9
The investigation	12
Background and key events.....	12
The Pensions Regulator’s comments.....	15
Mr L’s comments.....	15
Findings.....	15
Conclusion.....	16

Foreword

I am laying this report before Parliament under section 10(4) of the *Parliamentary Commissioner Act 1967* so that it is in the public domain. I know that the report is of interest to the people, and their MPs, who have complaints about the same matters which are the subject of this report.

In 2007 I accepted for investigation Mr L's¹ complaint about the Pensions Regulator. Mr L is a member of the Armstrong Pension Fund. He complained that the Pensions Regulator, when deciding to decline to impose a Financial Support Direction or Contribution Notice on the parent company of his former employer, which would have improved the funding position of his pension scheme, failed to exercise its statutory functions properly and its discretion reasonably. Mr L contended that as a result he, and many other pensioners in the scheme, have been prevented from receiving the level of pension they could otherwise have rightfully expected. My investigation did not find maladministration in the Pensions Regulator's handling of these matters. Therefore, I did not uphold Mr L's complaint.

Since I accepted Mr L's complaint for investigation my Office has received ten further requests for investigation on these matters with referrals from MPs from more than one political party. Putting this report in the public domain enables the outcome of my investigation of Mr L's complaint to be seen openly.



Ann Abraham
Parliamentary and Health Service Ombudsman
June 2010

¹ The complainant's name is anonymised to protect his identity.

Report by the Parliamentary Ombudsman of the results of an investigation of a complaint about the Pensions Regulator made by Mr L and referred by Graham Stuart MP

The complaint

- 1 Mr L complained that the Pensions Regulator, when deciding to decline to impose a Financial Support Direction (FSD) or Contribution Notice (CN) on the parent company of his former employer, which would have improved the funding position of his pension scheme, failed to exercise its statutory functions properly and its discretion reasonably.
- 2 Mr L contended that as a result he, and many other pensioners in the scheme, have been prevented from receiving the level of pension they could otherwise have rightfully expected. He seeks a full explanation of the reasons for the Pensions Regulator's decisions and reconsideration of the relevant decisions.
- 3 investigating by the terms of Schedule 3 to the 1967 Act, which lists administrative matters over which she has no jurisdiction.
- 5 Section 5(2) of the 1967 Act prevents the Ombudsman from looking into any matter in respect of which there is a right of appeal to an independent tribunal or other legal remedy, unless she is satisfied that it is not reasonable to expect the complainant to resort or have resorted to it. (There is no right of appeal available to Mr L and the Ombudsman is satisfied that it would not be reasonable to have expected Mr L to have sought a remedy through the courts.)
- 6 The Ombudsman's approach when conducting an investigation is to consider whether there is evidence to show that maladministration has occurred that has led to an injustice that has yet to be remedied. If there is an unremedied injustice, the Ombudsman will recommend that the public body in question provides the complainant with an appropriate remedy (in line with her *Principles for Remedy*). These recommendations may take a number of forms such as asking the body to issue an apology, or to consider making an award for any financial loss, inconvenience or worry caused. The Ombudsman may also make recommendations that the body in question reviews its practices to ensure that similar failings do not occur.

The decision

- 3 I have not found maladministration in the Pensions Regulator's handling of these matters. It follows that I do not uphold the complaint.

The Parliamentary Ombudsman's jurisdiction and role

- 4 When deciding whether the Ombudsman should investigate any individual complaint we have to satisfy ourselves first that the body or bodies complained about are within our jurisdiction. Such bodies are generally listed in Schedules 2 and 4 to the *Parliamentary Commissioner Act 1967* (the 1967 Act). The Pensions Regulator is so listed. Secondly, we must also be satisfied that the actions complained about were taken in the exercise of that body's administrative functions and are not matters that the Ombudsman is precluded from
- 7 Under section 12(3) of the 1967 Act the Ombudsman can only question the merits of a decision taken by a government department (the Pensions Regulator in this instance) in the exercise of a discretion vested in that department where there is evidence of maladministration. She cannot question a decision on the grounds simply that she or someone else might have reached a different

decision from the one that was actually made. If the Ombudsman does find maladministration in the way that a discretionary decision was reached, she cannot substitute her own judgment for that of the body concerned: she can only invite the department to take the decision afresh and without maladministration.

- 8 By virtue of her powers under section 8 of the 1967 Act, the Ombudsman may require any person who, in her opinion, is able to furnish information or documents relevant to the investigation to do so.

Basis for the Ombudsman's determination of the complaint

- 9 In simple terms, when determining complaints that injustice or hardship has been sustained in consequence of service failure and/or maladministration, the Ombudsman generally begins by comparing what actually happened with what should have happened.
- 10 So, in addition to establishing the facts that are relevant to the complaint, we also need to establish a clear understanding of the standards, both of general application and which are specific to the circumstances of the case, which applied at the time the events complained about occurred, and which governed the exercise of the administrative and clinical functions of those bodies and individuals whose actions are the subject of the complaint. We call this establishing the overall standard.
- 11 The overall standard has two components: the general standard which is derived from general principles of good administration and, where

applicable, of public law; and the specific standards which are derived from the legal, policy and administrative framework and the professional standards relevant to the events in question.

- 12 Having established the overall standard we then assess the facts in accordance with the standard. Specifically, we assess whether or not an act or omission on the part of the body or individual complained about constitutes a departure from the applicable standard. If so, we then assess whether, in all the circumstances, that act or omission falls so far short of the applicable standard as to constitute service failure or maladministration.
- 13 The overall standard which I have applied to this investigation is set out below.

The Ombudsman's Principles

- 14 In February 2009 the Ombudsman republished her *Principles of Good Administration*, *Principles of Good Complaint Handling* and *Principles for Remedy*. These are broad statements of what she considers public bodies should do to deliver good administration and customer service, and how to respond when things go wrong.
- 15 The same six key Principles apply to each of the three documents. These six Principles are:
 - Getting it right
 - Being customer focused
 - Being open and accountable
 - Acting fairly and proportionately
 - Putting things right, and
 - Seeking continuous improvement.

16 The *Principle of Good Administration* particularly relevant to this complaint is:

'Getting it right' – a public body should take reasonable decisions based on all relevant considerations.

The remit of the Pensions Regulator

17 The Pensions Regulator is the UK regulator of work-based pension schemes.² The *Pensions Act 2004* (the 2004 Act) gives the Pensions Regulator a set of specific objectives:

- to protect the benefits of members of work-based pension schemes;
- to reduce the risk of situations arising that may lead to compensation being payable from the Pension Protection Fund; and
- to promote, and improve the understanding of, good administration of work-based pension schemes.

Legislative and administrative background

18 The provisions of the 2004 Act which concern this complaint are part of the 'moral hazard' or 'anti-avoidance' provisions of that legislation, which were introduced towards the end of Parliamentary consideration of what became the 2004 Act. In the words of the press notice issued by the sponsoring government department, the Department for Work and Pensions (DWP) on 27 April 2004, which announced the introduction of these new provisions into the Bill following a period of consultation:

'The new clauses introduced by the Government amendments in the pensions bill aim to address the risks of so-called "moral hazard", particularly those posed by unscrupulous employers who might seek to use company structures and business transactions as a cover for avoiding their pension obligations and dumping their liabilities on the new Pension Protection Fund.'

19 After describing the rationale for the introduction of CNs, the notice continued, with regard to FSDs, by saying that:

'There may also be circumstances where, as a result of legitimate actions, not aimed at avoiding pension liabilities, schemes with a solvent group of companies could end up with a sponsoring employer who is unable to meet its pension liabilities. So, the second provision announced today will give the Pensions Regulator the power to require that financial support arrangements are put in place in cases where restructuring has either left service companies or subsidiaries with pension obligations that they can't meet.'

20 The Explanatory Note for what became section 43 of the 2004 Act said the following:

'Clause 43 gives the Regulator power to issue a direction requiring that appropriate financial support must be put in place, where it concludes that the sponsoring employer of a scheme is a service company, or is insufficiently resourced when compared to the assets and/or revenues of other persons to whom it is connected for it to be appropriate for that company to bear

² A work-based pension scheme is any scheme that an employer makes available to employees. This includes all occupational schemes, and any stakeholder and personal pension schemes where employees have direct payment arrangements.

the share of the group's pension liabilities applying to it.'

The Note went on to say this provision was aimed '*in particular [at] the debt on the employer under section 75 of the Pensions Act 1995 that would become due were the scheme to wind up*'.

21 A CN places the person to whom such a notice is issued under a direct liability to make good the specified pension shortfall. Sections 38 to 42 of the 2004 Act govern the Pensions Regulator's powers to issue CNs. Amongst other provisions, these provide that the Pensions Regulator has to be satisfied that the person to whom such a notice is to be issued was a party to an act, or a deliberate failure to act, which had as its main (or one of its main) purposes the prevention of the recovery by a pension scheme of a sum from the employer representing the statutory debt due to the scheme, as calculated under section 75 of the *Pensions Act 1995*. Further, the relevant act or failure to act must have taken place within the six years prior to the Pensions Regulator making its decision. In addition, the Pensions Regulator has to be satisfied that it would be reasonable in all the circumstances of the case to impose such a notice on the particular person.

22 The Pensions Regulator is empowered by section 43 of the 2004 Act to issue an FSD if it is of the opinion that the sponsoring employer is either a service company³ or if it is insufficiently resourced⁴ to enable it to discharge its

responsibilities towards a pension scheme which it sponsors. These powers have only been available since April 2005, however, with the full commencement of the 2004 Act's provisions.

23 Sections 43(5) and 43(6) of the 2004 Act provide that the Pensions Regulator may only issue an FSD:

(i) if the person to whom the direction is to be issued is the sponsoring employer of the scheme or someone who is or was connected with or an associate of the employer; and

(ii) where the Regulator is of the opinion that it would be reasonable to impose the requirements of the direction.

24 Section 43(7) of the 2004 Act sets out the factors that the Pensions Regulator must have regard to when deciding whether it is reasonable to impose the requirements of an FSD on a particular person. It says that:

'43(7) The Regulator ... must have regard to such matters as the Regulator considers relevant including, where relevant, the following matters –

(a) the relationship which the person has or has had with the employer (including... whether the person has or has had control of the employer...),

³ By 'service company', the Act (in section 44) is referring to a company whose turnover is solely or principally derived from amounts charged for the provision of the services of its employees to companies who were the other members of the same corporate group, as these terms are defined in companies' legislation.

⁴ By 'insufficiently resourced', the Act (also in section 44) is referring to situations where: the value of the employer's resources is less than 50% of the estimated debt due under section 75 of the *Pensions Act 1995*; and the value of resources of a connected or associated person (when added to the employer's resources) would be 50% or more of that debt.

(b) in the case of a person [being an individual connected with the sponsoring employer or otherwise their associate], the value of any benefits received directly or indirectly by that person from the employer,

(c) any connection or involvement which the person has or has had with the scheme,

(d) the financial circumstances of the person, and

(e) such other matters as may be prescribed.⁵

25 Section 43(7) of the 2004 Act lays down considerations that must be taken into account where relevant when the Pensions Regulator is determining whether it is reasonable to impose an FSD. These include whether the person on whom a direction is to be imposed has or had control of the sponsoring employer and also what are the financial circumstances of that person.

26 Section 45 of the 2004 Act sets out the types of arrangement that, pursuant to an FSD, may be put in place. Any arrangement established subsequent to the imposition of a direction has to be approved by the Pensions Regulator, and the Regulator must be satisfied that such an arrangement is reasonable in all the circumstances.

27 The ability of the Pensions Regulator to issue an FSD is only valid in respect of an existing

scheme. Section 43(10) of the 2004 Act provides that a pension scheme is in existence until it is wound up.

28 Under sections 82 to 87 of the 2004 Act the use that the Pensions Regulator can make of the information it has obtained in the exercise of its functions is restricted. It can only be used by the Pensions Regulator for the purposes of, or for any purpose connected with or incidental to, the exercise of its functions. The Pensions Regulator is generally debarred from disclosing restricted information to any third party (which would generally include individual members of a pension scheme), unless one or more of the exemptions listed applies. However, restricted information⁶ may be disclosed with the consent of the person to whom it relates and (if different) the person from whom the Pensions Regulator obtained it.

29 Section 95 of the 2004 Act prescribes a 'standard procedure' which the Pensions Regulator must comply with when it considers that it may be appropriate to exercise a regulatory function: this includes the issue of a CN or FSD. The standard procedure begins when the Regulator's regulatory staff issue a Warning Notice. If, after considering representations from the directly affected parties, the regulatory staff still consider that the use of one or more of the Pensions Regulator's powers may be appropriate, then the case will be referred to the Determinations Panel, which carries out certain delegated Pensions Regulator functions. (The functions exercisable by the

⁵ As of today's date, no other matters have been prescribed.

⁶ 'Restricted information' means any information obtained by the Pensions Regulator in the exercise of its functions which relates to the business or other affairs of any person, except for information:

(a) which at the time of the disclosure is or has already been made available to the public from other sources, or

(b) which is in the form of a summary or collection of information so framed as not to enable information relating to any particular person to be ascertained from it.

Determinations Panel are set out in section 10 of the 2004 Act.) The Determinations Panel, though a committee of the Pensions Regulator, is separate from the Regulator, in that it has a separately appointed membership, made up of people with relevant legal, business or pensions knowledge, and legal support. This enables it to make impartial decisions, based on evidence before it. The Pensions Regulator's staff told me that, in essence, this means that they operate a two-stage process, the first stage being that the regulatory staff consider whether the exercise of the section 38 or 43 powers may be appropriate. If, and only if, the Pensions Regulator does consider that the exercise of these regulatory functions may be appropriate is a Warning Notice issued and, if appropriate, the matter put to the Determinations Panel to decide. The Determinations Panel's decisions carry a right of appeal to a statutory tribunal, the Pensions Regulator Tribunal, and from there, on a point of law, to the Court of Appeal. This right of appeal is, however, only open to those directly affected by the issue of the CN or FSD. Trustees have no right of appeal against a decision by the regulatory arm of the Pensions Regulator not to exercise its regulatory powers (and therefore not to refer the case to the Determinations Panel), but they can seek judicial review of that decision.

- 30 In practice, therefore, the decision whether it is reasonable to issue a CN or FSD lies in the first instance with the team assigned to the case by the Pensions Regulator. Teams are generally made up of a business analyst, a case manager and a lawyer. In section 38 and 43 cases, key decisions are escalated to the business leader for the department in question and sometimes to the executive director responsible for that department.

- 31 One of the things the Pensions Regulator considers when deciding if it is reasonable to impose a CN is the relevant party's involvement with the pension scheme. The Pensions Regulator would consider the circumstances and may choose to liaise with any or all of the relevant parties (e.g. the trustees, insolvency practitioner, employer or potential target) where relevant to determine if the issue of a CN or FSD might be appropriate.

The investigation

- 32 In the course of the investigation we made enquiries of the Pensions Regulator, interviewed staff involved in the events complained about, and examined the Pensions Regulator's papers (including all the papers the Pensions Regulator relied upon in reaching its decision). We also took specialist advice from external lawyers with expertise in the *Pensions Act 2004*. We also shared our provisional report and findings with Mr L and with the Pensions Regulator and I have taken account of their comments in reaching my decision. I have not included all the information found during the course of the investigation, but I am satisfied that nothing of significance to the complaint and my findings has been omitted.

Background and key events

- 33 Mr L worked for the Armstrong Group (Armstrong), which made car components and was bought by Caparo Automotive Limited in 1989. Caparo Automotive Limited thereby became the principal employer of the Armstrong Group Pension Scheme, which at that point had surplus funds. From 1989 until 1998 Armstrong took what was known as a 'contributions holiday' and made no employer

payments to the pension scheme during this period. Contributions recommenced in 1999. In April 2002, however, Armstrong decided to wind up the pension fund.

³⁴ Under the law that pertained at the time (that is, the *Pensions Act 1995*), as the sponsoring employer had taken a voluntary decision to wind up the pension scheme, the employer was required to inject funds into the pension scheme to bring it up to the Minimum Funding Requirement (MFR) funding level. The pension scheme was accordingly assessed and was found at 30 November 2003 to have statutory debt under section 75 of the *Pensions Act 1995* of just over £36 million (the MFR would not provide sufficient funding to meet all the scheme's liabilities).

³⁵ The legislation did not require the necessary funds to be injected into the scheme immediately; it could be done over some years. It was also possible for the participating employers to seek agreement with the pension scheme trustees to compromise this debt and consequently for the employers to be required to pay in less than the total deficit as it had been actuarially calculated. In this instance although the section 75 debt was served on the employers in May 2004, the trustees agreed that it would not be enforced pending negotiations with Caparo Group Limited (in its capacity as the controlling company with ultimate responsibility for the participating employers). Negotiations on this continued throughout 2004 and into the early months of 2005, but did not result in resolution being reached. In May 2005, therefore, the trustees approached the Pensions Regulator to inform it that negotiations were on the point of breaking down and seeking its intervention. The same month Armstrong offered to pay a proportion of the deficit

from future profits, but the trustees were apparently advised that there was no realistic prospect of any such payments being made in the foreseeable future. The trustees did not therefore believe that this proposal was in the best interest of the scheme members and declined the offer. Caparo Group Limited made a subsequent offer of £3.2 million, conditional on them receiving the trustees' support for a clearance application that the Group were intending to make to the Pensions Regulator. The trustees refused that offer in February 2006.

³⁶ On 13 March 2006 the participating employers were placed in voluntary receivership. With effect from 15 May 2006 (when the relevant employer insolvency events were notified to the Financial Assistance Scheme (FAS) administrators), the scheme became (and is still) within the scope of the FAS as the scheme had commenced wind-up prior to March 2005 and as the participating employers were insolvent (or, more precisely, were to be treated as such) for the purposes of the FAS. Its members would thus be entitled to receive 'assistance' from the FAS at the time when the scheme was finally wound up. Caparo Group Limited subsequently bought Armstrong's business and assets.

³⁷ In August 2006 the trustees' representatives wrote to the Pensions Regulator, on the trustees' behalf, expressing concern at what they described as the delay by the Pensions Regulator in reaching a decision on the issue of an FSD or CN. On 7 September 2006 the Pensions Regulator sent the trustees its preliminary view, which was that it would not be reasonable for it to issue an FSD in this case. The trustees then had a meeting with the Pensions Regulator on 27 September 2006, during which the Pensions Regulator agreed to consider further submissions and evidence that the trustees

- wished to put forward in support of the case for an FSD, which the trustees subsequently forwarded to it. However, on 14 December 2006 the Pensions Regulator issued its final decision, which was that it would not be reasonable for the Pensions Regulator to exercise its powers under section 43 of the 2004 Act. The reason the Pensions Regulator gave for reaching that conclusion was that *'the overwhelming flow of benefit had been from Caparo Group Limited to the Participating Employer rather than vice versa'*. The Pensions Regulator did not go into further detail, in part because of the restrictions placed on it in respect of the disclosure of restricted information (paragraph 28), but also because the Regulator believed that the level of detail provided was sufficient for the trustees to understand the decision.
- 38 On 14 February 2007 the trustees' representatives sent the Pensions Regulator a submission in support of the issue of a CN. This argued that Caparo Group Limited had put the participating employers into administrative receivership with the primary intention of buying back their trade and assets as going concerns, but without the section 75 debt. On 10 April 2007 the Pensions Regulator responded saying that there was not sufficient evidence to support the contention that the main purpose or one of the main purposes of the act was to avoid the section 75 debt.
- 39 In June 2007 the trustees took the first step in judicial review proceedings, in the form of a letter before claim, on the grounds that the Pensions Regulator's decision letters of 14 December 2006 and 10 April 2007 had not contained adequate or any reasons for the decisions not to exercise its powers and issue a CN or FSD. In its response of 4 July 2007, the Pensions Regulator maintained that adequate
- reasons had been given but nonetheless, on an ex gratia basis, provided the trustees with a summary of the analysis which underpinned the reasons for not taking regulatory action. The trustees decided not to proceed to judicial review.
- 40 Mr L told us, however, that the trustees had apparently felt unable to share with the scheme members the additional information provided to them by the Pensions Regulator. As a consequence, scheme members, including Mr L, continued to press the Pensions Regulator to disclose its detailed reasons underlying its decisions not to exercise its regulatory powers in this instance. The Pensions Regulator subsequently decided that, given the level of frustration expressed by scheme members in relation to their inability to understand why the Pensions Regulator was unable to use its moral hazard powers, it would seek the consent of the trustees and the relevant corporate entities to the Pensions Regulator disclosing that information. However, in October 2008, the Pensions Regulator wrote to Mr L, amongst other scheme members, explaining that, whilst the trustees had given their consent to such disclosure, the corporate entities had not. This was on the grounds that disclosure would involve revealing commercially sensitive information, which they would prefer to remain confidential.
- 41 In the meantime, on 5 December 2007, the Ombudsman had accepted Mr L's complaint for investigation.

The Pensions Regulator's comments

- 42 The Pensions Regulator's staff told us that, in reaching their decision in this case, they had considered a great deal of information, including submissions and evidence received from the potentially affected parties. They had also encouraged the sharing of key submissions between the parties to ensure that the key issues of concern to the parties had been able to be debated, and thereafter considered by them.
- 43 The Pensions Regulator's staff told us that the key difficulty for them was that they were unable, because of the legal restrictions on what they could disclose to the pensioners affected, to explain the detailed reasoning behind the Pensions Regulator's decisions. They added, however, that that information had been provided to the trustees, who represented the scheme member's interests. The Pensions Regulator's staff said that they could understand why Mr L and others in the same position felt deeply frustrated by this, and indeed why it made them question whether the Pensions Regulator had taken those decisions appropriately. But there was nothing more that they could do about that, and they were satisfied that the matters in question had been properly considered.

Mr L's comments

- 44 Mr L's view of these events is that Caparo Group Limited took over the company he worked for and ran its previously healthy pension scheme into deficit, then distanced itself through a subsidiary company to escape liability for the pension difficulties.

- 45 Mr L believes that the 'moral hazard' provisions were specifically introduced to prevent what happened in this case, and he can therefore see no justification for the Pensions Regulator's decisions not to issue a CN or FSD. He believes the Pensions Regulator should force Caparo Group Limited to honour its 'obligations' to Mr L's pension scheme.
- 46 Having had sight of a draft version of this report, Mr L remained of that view. He held that the benefit flow was clearly in favour of Caparo Group; that their offer of £3.2 million implied acceptance of a debt to the pension scheme; that the move to place the participating employer in receivership was done solely for the reason of avoiding the debt; and that more emphasis should have been placed on the substantial assets of Caparo Group at the time the decision was taken to wind up the scheme.

Findings

- 47 Mr L's complaint (as set out in paragraph 1) is that the Pensions Regulator failed to exercise its statutory functions properly and its discretion reasonably. The first question to be considered is therefore whether the process that the Pensions Regulator has followed is in line with the relevant statutory provisions.
- 48 We have accordingly looked very closely at the process the Pensions Regulator followed, and in particular whether we are satisfied that the two-stage process described in paragraph 29 is in line with the provisions set out in section 95 of the 2004 Act. We are satisfied that it is, and that the Pensions Regulator was therefore acting within its statutory powers in this regard.

49 The next question is, therefore, whether the Pensions Regulator has ‘got it right’ (paragraph 16) in terms of its discretionary decision-making. In other words, has the Pensions Regulator reached a reasonable decision based on all relevant considerations? This involves considering whether the Pensions Regulator has misdirected itself as to a matter of law, or has failed to have regard to all relevant considerations, or has had regard to an irrelevant consideration.

50 The key difficulty we face here is how little of the evidence we have seen and considered can be set out in this report. Although the Ombudsman can require to see all the evidence relevant to her investigation (paragraph 8), and reflect that evidence in her report of her investigation to explain the decision she has reached, to do so in this instance would completely undermine the provisions of the 2004 Act, which are specifically designed to preserve the confidentiality of certain restricted information provided to the Pensions Regulator (paragraph 28). It would clearly not be appropriate for the Ombudsman to subvert the intention of Parliament by releasing that information through her report.

51 The most that I can therefore do in this report is to reassure Mr L that we have looked very closely at all of the relevant papers, and have considered very carefully the implications of their content. We have also shared key relevant documents with our specialist external advisers and discussed the information we have seen with them, as well as the content and intent of the relevant legislation. Having done so, we are satisfied that there is no evidence to suggest that the Pensions Regulator has misdirected itself as to a matter of law, or has failed to have regard to all relevant considerations, or

has had regard to an irrelevant consideration. Accordingly, there is no evidence to suggest that the decision the Pensions Regulator reached was wholly unreasonable, and therefore no evidence that it exercised its discretion unreasonably.

Conclusion

52 I do not uphold Mr L’s complaint. I am satisfied that the Pensions Regulator acted within its statutory powers and did not exercise its discretion in an unreasonable way.

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