

The Government Response to
the Public Administration
Select Committee's Sixth
Report of Session 2005–06
*The Ombudsman in Question:
the Ombudsman's report on
pensions and its constitutional
implications [HC 1081]*



Department for Work and Pensions

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On 30 July 2006 the Public Administration Select Committee published its report on the Parliamentary Ombudsman's report on occupational pensions *Trusting in the Pensions Promise*. This is the Government's response to the conclusions and recommendations in the Select Committee's report.

Presented to Parliament by the Secretary of State for Work and Pensions
by Command of Her Majesty
November 2006

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The Government Response to the Public Administration Select Committee's Sixth Report of Session 2005–06 *The Ombudsman in Question: the Ombudsman's report on pensions and its constitutional implications*

1. The Government recognises the Select Committee's report as a significant contribution to a deeply difficult issue.
2. In its report the Committee made three basic points:
 - (a) It expressed concern over what it saw as the Government's apparent readiness to dismiss the Ombudsman's findings.
 - (b) It recommended that the Government arrange more generous recompense than is provided by the Financial Assistance Scheme (FAS).
 - (c) It agreed with the Ombudsman that maladministration had occurred.

This response takes each of these points in turn. A specific response to each of the Committee's conclusions and recommendations is given in the Annex.

The Ombudsman's Position

3. The Government's position on this is clear and unambiguous. It has, and will continue to have, absolute respect for both the office of the Ombudsman and its office holder. While there have been instances in the past, under different administrations, of a Government not accepting a finding of maladministration by the Ombudsman, such instances have been highly exceptional and the Government has every intention that they should remain so in the future. The Ombudsman has, and will continue to have, the total and unqualified respect of the Government.

Recompense

4. The Government fully recognises the very substantial hardship and distress suffered by those who have lost their pensions and we have, as requested by the Committee, looked again in great depth at what more might be done. We have further explored the alternatives to public funding but, as we explain in the report, we have concluded that none of these are feasible. We do, however, appreciate the very difficult situation faced by those people we are not able to help through FAS, and have said we will consider all sensible options for the administrative operation of the scheme.
5. We note the Committee's view that "we will not tell the Government what it should do, or attempt to prescribe a precise level of compensation. We expect the Government to put together a significant package of support." The Government agrees there should be a significant package of support and believes that FAS, as extended, constitutes such a package.

The Financial Assistance Scheme

6. Over the last two years, we have very worked hard to put in place an appropriate package. The Pensions Act 2004 introduced FAS for defined benefit occupational pension schemes that began to wind up before April 2005, with an insolvent employer and were underfunded. The Pension Protection Fund was also introduced for defined benefit schemes with insolvent employers that began to wind up after that date.

7. The Government took very full account of the issues raised in the Ombudsman's report when conducting the recent review of FAS. As a result of that review we extended the package of support on 25 May 2006. The funding available for FAS was very substantially increased, from £400 million in cash terms (£243 million net present value) to £2.3 billion in cash terms (£783 million net present value).
8. Those who were within 15 years of their scheme's normal retirement age when the scheme began to wind up will now get at least 50% of their expected core pension. As a result we envisage that around 40,000 people may benefit from FAS (a significant increase on the 15,000 expected to be helped by the original scheme). This will do much to help those who have suffered from significant losses but are least likely to be in a position to make up the shortfall because of their age – which we believe to be the right principle to adopt.
9. We recognise the Committee has argued that there should be a further extension of the current FAS. The current scheme does meet some of the suggestions of the Committee – for instance, that there should be survivor benefits, and that payments should be made regardless of whether the scheme has wound up completely or is still in the process of winding up.
10. The Committee has not argued that the Government was responsible for schemes winding up underfunded, nor that it should pay compensation in full.
11. This is not an argument solely about affordability. If the Government had been responsible for these losses, or if the schemes in question had been Government schemes, there would be a powerful argument that the Government should put things right. For example, in the case of the State Earnings-Related Pension Scheme (SERPS) the Government accepted responsibility for a failure to publicise changes to the inheritance rules and undertook to put things right. The Government accepted that responsibility because SERPS was part of the State Pension for which the Government was and is wholly responsible.
12. The question is therefore where the balance should be struck between supporting those who have suffered losses and meeting our obligation to the taxpayer. As the preceding paragraphs indicate, the disagreement between the Government and the Committee is not about **whether** there should be some support, but about **how much** support there should be.
13. The Government continues to believe that FAS strikes the right balance between these two objectives. It is both a very significant improvement on what was available before the 2004 Pensions Act and also, in our view, at the limit of what the taxpayer can properly be expected to support. We understand that the vast majority of people who have lost money were members of their schemes before both the Minimum Funding Requirement was introduced and our leaflets were published. It is unlikely in the extreme that anyone transferring their rights out of their scheme would have been able to protect them in full and, in some cases, they may have been left in a worse position. Even if we had accepted the claims of maladministration made, which we do not, we would have required people, in such an event, to prove a case for compensation and it is unlikely that many people would have been able to do this successfully. In contrast, under the extended FAS, it is immediately clear that around 40,000 people can benefit.
14. We have, however, looked again, in the light of the Committee's report, at what extra support can be made available within the existing framework. One option, which is not being widely taken up currently, is Deemed Buy Back. This is a facility which, provided certain conditions are met, reinstates (in full or in part) a member of an underfunded contracted-out pension scheme into the Additional Pension (now the State Second Pension, previously SERPS) for the period they were in an underfunded scheme, without having to pay the full cost of buying back into the state system. The remaining money in the scheme relating to the member is paid to the Government, the shortfall being deemed to have been paid (hence the name 'Deemed Buy Back').

15. Deemed Buy Back needs to be carefully considered on an individual basis. Complex issues can arise where a member of an underfunded scheme had also been a member of other contracted-out occupational pension schemes in the past, in which case reinstatement into the Additional Pension may not always be worthwhile. Despite these complexities, we believe that Deemed Buy Back could provide useful help, in particular to those who a) are beyond the 15 year cut-off age for FAS and/or b) have the lowest pension entitlements currently.
16. The Government therefore asked the Government Actuary's Department (GAD) to estimate how many scheme members might meet the current qualifying conditions for Deemed Buy Back. GAD has estimated, based on the very limited and incomplete information currently available to it, that this number could be around 10,000 people.
17. Although the advisers of schemes in wind-up should already be aware of the existence of Deemed Buy Back and ought to consider whether it could be of benefit to the members of the particular scheme, the Government is planning to publicise these arrangements more widely and proposes to work with interested parties to investigate what more should be done in this respect. We also intend to examine whether the Department for Work and Pensions can produce a tailored forecast, for each person who qualifies for Deemed Buy Back, of the Additional Pension they could receive.

Maladministration

18. We note and accept the Committee's injunction that the Government's response should not be defensive. However, we continue to believe that the Government is not responsible for the losses in question and we think it important to set out why we take that position.
19. The pension schemes in question were not the Government's schemes. They were provided by employers and underwritten by the employers' contributions. The employers, not the Government, made promises to their employees. While the Government did prescribe the overall legal framework, it was the trustees who were required to make decisions based on the specific circumstances of their scheme and it was the employers' responsibility to meet the promises they made to their employees. At no time did the Government underwrite these promises.
20. As the leaflets considered in the report made clear, they were never intended to be a full statement of the law, or to provide sufficient information for the individual to make a financial decision of the magnitude of how to save for retirement. They were introductory leaflets, at a high level of generality. We accept that individuals should have been able to rely on their accuracy, for the purpose for which they were intended, namely to understand the basics of what a pension is. We continue to believe they met that standard. We do not accept that individuals should have made significant decisions about their pension saving on the basis of an introductory government leaflet.
21. The Government has already explained in detail why it does not believe that the information it issued was inaccurate or misleading. The Government believes its leaflets made clear the limitations of the information provided. We do not agree that these leaflets were appropriate vehicles for explaining what could possibly happen in the event of a scheme going into wind-up. This could only have been covered accurately by specific information on individual schemes provided by the schemes themselves.
22. The Committee agrees that the Government prescribed the regulatory framework for occupational pension schemes and, as such, was not a bystander. However, no legislation replaced the fundamental responsibility of trustees and sponsoring employers to ensure that the pension benefits offered by their scheme were appropriately funded in order that they could be paid as they fell due. For instance, the Minimum Funding Requirement (MFR) introduced – for the first time – a prescribed **minimum** level of funding. This did not prevent trustees and employers of individual schemes agreeing to a higher level of funding targets where they considered it appropriate for their scheme.

23. The Government accepted the recommendation made by the Ombudsman that a review should be conducted to establish what could be done to improve the time taken to wind up final salary schemes. This work has now been completed and the Government has today published a report on this review called *The Speeding Up Winding Up of Occupational Pension Schemes*.
24. The Government has given long and careful consideration to the Committee's report. It maintains its position that the information issued was not misleading and that the Government is not responsible for the losses experienced by the individuals affected. The Government believes FAS offers significant support to those who are closest to retirement age and represents the appropriate level of assistance that should be expected of the taxpayer.

Conclusions and Recommendations

- 1. We have made our own investigations. We believe the Government is being, at best, naïve, and, at worst, misleading. (Paragraph 21)***

The Government set out its position in respect of its leaflets in the response which it laid before Parliament on 6 June. The Government believes this remains valid.

The Government welcomes the Committee's acknowledgement that statements, press releases and leaflets need to be taken in context and that statements to Parliament and press releases are, by their nature, particularly context-specific.

- 2. In our view, the nature of the Minimum Funding Requirement is not a matter of specific and detailed advice: it goes to the heart of the legal framework intended to protect pensions at that time. We fully accept that the 1995 Act had been intended to improve safety for occupational pensions, and may indeed have done so, but the explanatory material issued should have made clear the limitations of any protection. (Paragraph 32)***

The Government notes, but, after careful consideration, cannot accept, the Committee's view. The difficulty of ensuring a "general understanding of the purpose and limitations of the MFR" should not be underestimated. This would have required an explanation not only of the level of protection offered to non-pensioners by the MFR, but also of the concept of actuarial valuations, the valuation cycle, the time allowed for schemes to meet the MFR and, in addition, the transitional arrangements put in place.

The Government remains of the view that this level of technical information would not have been appropriate for the general, introductory leaflets considered by the Committee. What individuals needed was information about the funding level of their own particular scheme. This could not be provided by the Government but was available from the scheme itself.

- 3. We agree with the Parliamentary Ombudsman that the Government itself prescribed the regulatory framework for occupational pension schemes and, as such, was not a bystander. Once the Government had chosen to give information about the pensions system, that information should have been complete and accurate. Any limitations should have been made clear. A reasonable reader would have expected the official leaflets on pensions to have covered all the important points about occupational pensions. In fact, they did not mention one of the greatest risks. This is clearly maladministration. (Paragraph 33)***

The Government's position remains as set out in the *Response to the Report by the Parliamentary Ombudsman* which it published on 6 June.

That response makes clear why it believes that the information given by the Department for Work and Pensions and its predecessors was not misleading, and emphasises that its limitations were made clear by an explicit warning on each leaflet, saying that it was guidance only and not a complete statement of the law. Each leaflet offered appropriate information for its intended audience.

The Government does not believe that it was appropriate to cover all the risks of membership of an occupational pension scheme in these general introductory leaflets.

- 4. The Government should have been aware that the Minimum Funding Requirement was not properly understood by scheme trustees, let alone scheme members. Official information on the MFR was limited, and the information directed at prospective scheme members contained nothing about the MFR at all. Government should have realised that more clarification was required. (Paragraph 37)***

The MFR was a technical issue which schemes needed to understand and thus the official information issued was aimed at a professional audience – the Occupational Pensions Regulatory Authority issued a guide to the MFR for scheme trustees in May 1999. Trustees also had available advice from their professional advisers (the scheme actuary, for instance) and it was their general duty to ensure they had sufficient information to carry out their responsibilities. For the public, more general information was required – it is unrealistic to expect the Government to explain pensions law (and its detailed impact on individual pension schemes) in detail in every pension leaflet.

However, as a response to general concerns over trustee knowledge, in the 2004 Pensions Act Parliament has placed an explicit requirement on trustees that they must be conversant with scheme documentation, and have appropriate knowledge and understanding of the law relating to pensions and trusts, as well as the principles relating to scheme funding and investments. These requirements complement the trustees' existing statutory duty of care.

5. *A proper level of accuracy in government information should be a basic principle of good administrative practice; for many years, the information provided on occupational pensions fell far short of this, and of the Government's own declared standard. (Paragraph 40)*

The Government agrees with the Committee that official leaflets should be accurate. For the reasons explained in the *Response to the Report by the Parliamentary Ombudsman* which it published on 6 June, the Government considers that the leaflets were not misleading.

6. *The Government's response to our questions suggests there is little chance of recompense for those who lost significant pension entitlements when their scheme was wound up by a solvent employer. The Government cannot simply abandon such people; if it is impossible to make employers take responsibility, then it should do so itself. (Paragraph 54)*

The Government appreciates the very difficult situation faced by many members of these schemes, and has defined insolvency as widely as possible for the purposes of FAS in order to cover schemes where the employer no longer exists as well as those schemes where the employer has entered formal insolvency proceedings.

However, when an employer continues to exist, the Government believes it is unreasonable to expect the taxpayer to take responsibility for that employer's pension scheme given that it clearly has a duty to support its scheme and provide the benefits members were expecting.

While the Government does not believe that it would be right to help people in this situation through FAS, we have said we will consider all sensible options for the administrative operation of the scheme. We have, in particular, looked at a proposal that pensions be paid on an ongoing basis from the remaining assets of such schemes. However, after discussing this proposal with relevant stakeholders such as the Pension Protection Fund, we have reluctantly concluded that it would not be workable.

Members of schemes subject to solvent employer wind-ups may qualify to participate in the Deemed Buy Back scheme (described on page 2), which provides a measure of protection for them. We are investigating ways of publicising this facility more.

7. *We believe the Government should look again at what can be done. Like the Ombudsman, we "want a response which is not about defensiveness and denial, it is about constructive engagement and putting things right ... not into defending what has gone wrong." Like the Ombudsman, we will not tell the Government what it should do, or attempt to prescribe a precise level of compensation. We expect the Government to work with others to put together a significant package of support. The main elements of such a package should include compensation for scheme members, regardless of their age, measures to ensure payments begin at the age of 65, regardless of whether a scheme's wind-up has been completed, indexation for pensions, and security for dependents' benefits. (Paragraph 57)*

The Government acknowledges the concerns expressed by the Committee about the position of affected scheme members. While the Government maintains its view that it is not liable to pay any compensation, as the losses incurred were not caused by any government action, it has, over a period of two years, closely considered the position of this group of people and put together a significant package of support.

The Government remains of the view that the only practical source of funding is the taxpayer. The Government has had to strike a balance between helping those most affected by these losses and the rights of the taxpayer. The Government has now allocated well over £2 billion of taxpayers' money to fund FAS and to help around 40,000 of those affected who are closest to, or at, retirement. The Government believes this is the right balance. To replace benefits in full would require the commitment of significant sums of taxpayers' money over many years. FAS does, nevertheless, meet some of the criteria laid down by the Committee: payments can begin at 65 regardless of whether a scheme has completed wind-up, and assistance is payable to surviving spouses and civil partners.

In addition, those who qualify for FAS might also benefit from the Deemed Buy Back process explained on page 2.

The Government has, as the Committee recommended, also considered with great care various proposals put forward for alternative methods of funding any assistance, but on examination has not found any of them to be practicable. For instance, to take the suggestions of the Ombudsman quoted by the Committee:

- **Unclaimed assets** – apart from the fact that these assets are not held or controlled by the Government, the estimate of the amount available from this source comes nowhere near the amount required. It is estimated that there are several hundred millions of pounds in unclaimed assets held in bank accounts – nothing like the estimated £3 to £4 billion (net present value) that it is estimated it would cost to replace in full the lost benefits.
- **Contributions from the financial industry** – there is specific legislation in place to allow for financial contributions for FAS and the Government did, when establishing this scheme, make contact with various organisations. However, while assistance on designing the scheme was offered, no financial contribution was forthcoming. There is no evidence to suppose the situation would be any different now.
- **Funds in schemes** – as the Government made clear, the estimates it published on costs took account of the money remaining in the schemes in question.
- **Not annuitising** – the Government has looked at whether, rather than annuitising individual members' remaining funds, running schemes on would produce savings which could be used to increase payments. In fact the opposite might be true. Such an approach could require the schemes to pay lower pensions in order to retain funds to cover future liabilities and would not offer individuals any certainty as to their future income.

8. *It is not unprecedented for the Government to contest an Ombudsman's finding of maladministration. It is, however, unprecedented for there to be so many problems, in such a short space of time. Our scrutiny leads us to conclude that the fault lies with the Government, not the Ombudsman. (Paragraph 70)*

The Government notes that the Committee accepts that, on occasion, Governments can contest an Ombudsman's findings of maladministration. However, it is, as the Committee has demonstrated, extremely rare for the Government to do so – between the establishment of the Ombudsman's office in 1967 and 2005 Governments had only rejected an Ombudsman's findings of maladministration on a small number of occasions. The Government reiterates that such instances have been and will remain highly exceptional.

In this particular instance, the decision was made and notified to the Ombudsman on 15 March 2006, the day the Ombudsman's report was published. The Government had, however, seen a draft of the report in December 2005 and had, therefore, been considering her recommendations for over two months. The document published in June was an explanation to Parliament of the reasons behind this decision – reasons of which the Ombudsman was already aware, as a consequence of the exchange of letters between her and the Department for Work and Pensions' Permanent Secretary.

9. *We share the Ombudsman's concern that the Government has been far too ready to dismiss her findings of maladministration. Our investigations have shown that these findings were sound. It would be extremely damaging if Government became accustomed simply to reject findings of maladministration, especially if an investigation by this Committee proved there was indeed a case to answer. It would raise fundamental constitutional issues about the position of the Ombudsman and the relationship between Parliament and the Executive. (Paragraph 78)*

The Government has never dismissed the findings of maladministration made by any Ombudsman lightly or without very full and careful consideration. While there have been what the Ombudsman has described as a "cluster" of reports that have been disputed over this past year, this does not in any way indicate a change in the approach taken by the Government as a whole. Each of these reports was considered carefully and separately by the department concerned – there was no concerted response – and the central guidance issued by the Cabinet Office on handling Ombudsman enquiries has not changed.

10. *We trust that this Report will act as a warning to the Government. We will continue to monitor the Government's responses to the Parliamentary Commissioner's reports. If necessary we will seek a debate on the floor of the House, so that all Members can discuss these issues, and re-establish the Parliamentary Commissioner's role. The Parliamentary Commissioner is Parliament's Ombudsman: Government must respect her. (Paragraph 79)*

The Government has great respect for the Office of the Parliamentary Commissioner and for the office holder. Of the recommendations which her office made in 2005/06 over 99% were complied with. The Government also recognises the vitally important constitutional role that the Ombudsman fulfils, and is fully committed to maintaining a strong and positive relationship with her and her staff. It is currently working closely with the Ombudsman to support her in the development of a set of principles of good administration. As the Cabinet Secretary, Sir Gus O'Donnell, announced to the Committee on 16 May 2006, Paul Gray of HM Revenue and Customs has taken on the role of Permanent Secretary "Champion" for Parliamentary Ombudsman issues. His appointment reflects the importance the Government places on the Ombudsman's role and on ensuring that there is a positive and constructive relationship between the Government and the Ombudsman.



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