

INADEQUACIES OF THE FINANCIAL ASSISTANCE SCHEME

The FAS is simply not working. Of 10,000 or so members already past pension age, only about 400-500 have had any money at all, and these are only the 'interim' payments. The system is too slow and cumbersome and, even though trustees of schemes have money they could pay immediately to members over pension age, the DWP will not allow them to and is forcing members to wait until wind-up is completed. The 'extension' to the scheme is only for people who are still many years away from retirement, whereas those in most urgent need are the ones who need their pensions now, but are not getting them.

I don't think MPs really have understood just how low the FAS payments really are. The DWPs final response to the Ombudsman's report (laid in Parliament on 7th June 2006) states that the FAS will pay 80% of the 'expected' pension of those within 7 years of scheme pension age, 65% of 'expected' pension for those 7-11 years away and 50% of 'expected' pension for those up to 15 years away. This is not correct. The statement misleads MPs into thinking that members will have most of their pension back. That is far from the truth. In reality, many of those on the "80%" band will still lose about half their 'expected' pension, those in the "65%" band will often only well under half of their 'expected' pension and most of those on the "50%" band will only get between a quarter and a third of their scheme entitlement, so members are still suffering dreadful losses.

The cost of the FAS has been overstated in two ways. The DWP says that the extension to the FAS will mean taxpayers spending another £1.9bn on the scheme, but this is not correct. Firstly, as James Purnell confirmed in the Commons on 20th June, the net present value of the extension to the FAS is only £540m and this is spread over 50 years. Treasury and all experts agree that 'cash costs' are not appropriate for measuring costs over long periods of time, unless you want to exaggerate the true cost. Government figures only use cash costs for shorter term spending, perhaps over 5 years or so, but not for 50 years.

Secondly, the DWP costs for FAS did not allow for the fact that all FAS payments are taxed. Furthermore, many of those receiving assistance will lose some means tested benefits they would otherwise get, making the net cost to the taxpayer lower still.

MPs seem unaware of just how inadequate the FAS truly is. Not only have so few people received anything, but even when they do, the payments will be far less than the pension they were expecting. This is because the FAS calculations are based on what the DWP called 'core' pension, which is worth far less than members' 'expected' pension. For example:

- FAS payments are not inflation-linked at all – the 'expected pension' would be
- FAS only starts full payment when wind-up has actually finished
- FAS starts at age 65 – 'expected pensions' start at scheme pension age (often below 65)
- FAS payments are capped at £12,000 and this cap itself is not inflation-linked, so it declines in value over the years
- Entire FAS payments are taxed whereas expected pensions include a tax-free lump sum
- FAS only pays 50% of the FAS benefit to a surviving spouse – whereas the scheme would normally pay spouses at least 50% of members' full 'expected pension'
- FAS payouts to widows halve immediately, if a member dies soon after retirement, but schemes usually continue paying full pension to surviving spouses for a few years
- If members die young, FAS pays nothing and survivors are left without any insurance – 'expected pension' benefits include life assurance cover and ill-health benefits

Other problems with the FAS:

- Solvent employer schemes are excluded.
- Anyone over 15 years from pension age is excluded, so people in their 50's who saved for over 25 years in their company scheme still get nothing
- In fact, all those not included in the FAS will get even less than they would have had without FAS, because trustee expenses incurred in submitting FAS data are taken out of scheme assets. So FAS further reduces pensions for those who get no FAS.

SUMMARY OF INADEQUACIES OF FAS EXTENSION

1. **Government has exaggerated the cost.** Claims that it will cost taxpayers around £2bn over 50 years are not right. The net present value of the extension to the scheme is just £540m over 60 years (see James Purnell Commons Answer 20th June 2006) and even this will be further reduced because all payments are taxed and some recipients will not get means tested benefits.

2. **FAS has not paid out to many people – already 10,000 past pension age, but only about 500 have had any money.** Most of those affected are not sure when they will get help. Their suffering goes on and it seems the Government has not understood the scale of human misery. The extension of FAS only applies to people in years to come. It did nothing for those in need now.

3. **Government has exaggerated the amount people will get.** They will not get 80% of their scheme pension, but only of what is called 'core' pension, which is much lower, because FAS excludes inflation-linking, has no tax free lump sum, does not start till wind-up is finished etc. In reality, many of those on the "80%" band will still lose about half their 'expected' pension, those in the "65%" band will often receive under half their 'expected' pension and most in the "50%" band will only get a quarter or a third of their scheme entitlement, so FAS still entails dreadful losses.

4. **The whole FAS payment is taxed** whereas the scheme pension would have tax free lump sums. So not only is the member receiving far less pension, they also pay more in tax.

5. **Members who were expecting to retire at scheme pension age have to wait till age 65 and conclusion of wind up!** Even women not paid till 65. Many schemes have assets available now in a bank, but FAS refuses to allow trustees to pay even the equivalent of FAS payments straight away to those already past age 65 or terminally ill and then claim this money back later. Members are losing 5 years worth of pension in many cases if their scheme pension age was 60.

6. **Without any inflation-linking,** the value of the payments from FAS will decline over time. Within 10 years, the value would be cut by over 20% in real terms.

7. **£12,000 pension cap is too low and the cap is not inflation-linked,** so the real value of the cap will wither away and take away much more of people's pension than currently appears to be the case in the headline figures. By the time those 15 years from pension age get their payments from FAS, the value of the cap will be more like £8,000!

8. **The FAS does not provide any explicit recognition for the losses of the 'Guaranteed' Minimum Pensions'** which should have come from the SERPS National Insurance system, and which Government said would replace contracted out rights with benefits '*at least as good as*' those given up in the state scheme.

9. **Spouse benefits much lower than scheme benefits.** FAS only pays 50% of FAS benefit to a surviving spouse – whereas the scheme would normally pay spouses at least 50% of members' full 'expected pension'. Also FAS payouts to widows halve immediately if a member dies soon after retirement, but schemes usually continue paying full pension to surviving spouses for a few years

10. **Members of schemes winding-up with solvent employers are excluded**

11. **Excluding those over 15 years from pension age** means people in their 50's who contributed for over 25 years and have no means of redressing this loss will get no help.

12. **Those excluded from FAS get even lower pensions!** FAS has required significant amounts of trustee time to submit paperwork and data. In sending this FAS information, schemes have incurred trustee expenses, leaving even less assets for all members' pensions. Therefore, the FAS is taking even more money away from members whose pensions have already been decimated, in order to give some assistance to those who do qualify for the FAS.

Government says members should have taken advice and not relied on the Government

That is not it said at the time and it is unacceptable to try to reinvent history. At the time, Government said its information was being produced for members to rely on and the material does not say members must take independent advice. It refers members to their scheme and trustees, but members had that information and were looking for confirmation from Government. It was Government that put in the rules, so why would members doubt their words of reassurance?

This is not just about some Government leaflets

It is about far more than this. Firstly, it is about the inadequate oversight of the MFR regime. Secondly, it is about the effect of the legal priority order which members were never told about. Thirdly, it is about a sustained campaign of misinformation which Government was in charge of, designed to lull members into a false sense of security about their pensions and showing more concern for employers than for members' interests.

Deemed buyback is not working in practice

The Government has recently suggested that deemed buyback might help replace lost pensions. Unfortunately, deemed buyback does not really work, but because of its complexity, most MPs do not actually understand what is involved. Firstly, deemed buyback is only a replacement for the pre-1997 state pension rights that members would have had anyway, if they had never paid into a company scheme in the first place. They will still be losing their entire occupational pension that came from their own and employers' contributions. Secondly, deemed buyback does not even replace the lost national insurance pension rights in full. Thirdly, the Inland Revenue says members must surrender their Additional Voluntary Contributions (AVCs) if they take deemed buyback – even though these were supposed to be protected above all other scheme benefits. The Inland Revenue says that it is taking the AVCs because the law does not specifically exclude it from doing so and if members want to challenge this then they should sue the Government! This is bordering on an abuse of power. Fourthly, in practice, to accept deemed buyback members are told they need financial advice, but they cannot find anyone to advise them. This is because the trustees will not do so, the Citizens Advice Bureau say they can't help, and even financial advisers are unable to advise because the Inland Revenue will not say how much pension will be received on deemed buyback anyway. So members are being asked to make a choice, but do not know what they are choosing and cannot get any advice to help them. They receive about 20 pages of information which they do not understand and once they have made their decision, it is irrevocable, so even if they do the wrong thing there is no comeback on anyone.

Government justification for £12,000 cap

Mr. Purnell has tried to justify a £12,000 cap as follows: the average retired household receives occupational pensions of less than £5,000 a year, 90% of pensioner households have private pension income of less than £12,000 a year, and most taxpayers have no defined benefit pension, so taxpayers cannot be expected to assume responsibility for pension scheme liabilities of those who do. Just because the majority of the population do not save, or have not set aside enough money to have a decent pension, does not mean that those who have done so should be penalised. If members had been warned that their pensions were only safe up to £12,000 a year, they would have known the risks and could have saved elsewhere or taken other steps to protect themselves. In any case, the sums required for compensation are tiny compared to the £10billion a year spent on higher rate tax relief – which taxpayers spend on providing top earners with generous pensions, even though those taxpayers do not have such pensions and mostly cannot afford such high contributions. In addition, we spend £10billion a year on contracting out rebates and also hundreds of millions on giving more tax-free cash to top earners' pensions after 2006 pension tax simplification changes. Why is taxpayer's money justifiably used for this, but denied to the victims of Government negligence who put their entire life savings into a scheme the Government assured them was safe?

Government said 'Guaranteed' Minimum Pensions would replace contracted out benefits

Members' occupational pension entitlements generally consist of two main parts.

- a. ***Their Guaranteed Minimum Pension (GMP) which is just a replacement for their pre-1997 National Insurance additional pension***

b. Their occupational pension This other element of members' occupational pensions comes from their own contributions into the scheme and the contributions made on their behalf by their employers. This is their *actual* company occupational pension.

Most final salary schemes were contracted out of the state earnings related pension system (SERPS/S2P), and national insurance rebates were paid to the schemes, to provide a replacement for the pension rights that members would have received if they had stayed in SERPS. Government said these rebates would give what it called a 'Guaranteed Minimum Pension'. But, it has turned out that after 1997 *neither* the Guaranteed Minimum Pension, nor the company pension element were truly protected, despite repeated Government assurances that these pensions were safe! Yet, the proposed FAS regulations make no special arrangements for the part of the occupational pensions which came from contracted out rebates (as a replacement for state scheme rights). It was actually *Government* that called this a 'Guaranteed Minimum Pension' – not the employer, or the trustees or financial advisers – but it was neither 'guaranteed' nor 'minimum'. How can the DWP deny responsibility for this? This part of the occupational pensions of the winding-up scheme members could be taken back into the state system for free – as happened in the case of the Maxwell scandal. Taking GMPs back into the National Insurance system would also make winding up all these schemes much quicker and simpler.

Why solvent employer schemes should be included

The Government's rationale for excluding solvent employer schemes is that such employers 'have a duty to support their schemes'. This rationale is flawed. The employers have complied with the law and even if companies could afford to pay the pensions in full, scheme members are powerless to force them to do so. Inadequate oversight of the MFR (the Government's Minimum Funding Requirement, which was all that employers needed to meet when winding up a pension scheme) meant this funding measure became totally inadequate for delivering members' promised pensions, although that was its original intention. If Government believes the employers should pay up, then scheme members should be helped and Government itself should try to recover the costs, if they can! Also, in some cases, trustees agreed a compromise deal, in order to save the company from insolvency, and now the pension scheme members are being penalised for this. Members of solvent employer schemes have suffered the same injustice as others and should be included.

Members' assets should not be wasted on buying annuities

The PPF will not be buying annuities, because buying annuities entails paying a profit and risk margin to the insurers who provide them. Why then is the DWP insisting that trustees of these winding up schemes must proceed with buying annuities? Bulk annuities have become extremely expensive. Instead, the scheme assets should be used to fund ongoing pension payments year by year, as will be the case with the PPF, topped up by extra contributions raised by Government. If annuity purchase is stopped or unwound, the Government would also have many years over which to set aside money to pay FAS compensation, rather than having to find large sums now. The Government could pool all the assets and run the FAS alongside the PPF, with additional funding coming in to provide ongoing pensions over time.

CONFIDENTIAL SUGGESTIONS FOR COMPENSATION

SUMMARY:

1. Take contracted out state rights back into the National Insurance scheme (at least for the GMP entitlements pre-1997). Issue an interest free loan to trustees to cover the costs of this.
2. Set up a trust fund to collect money and use unclaimed assets for a rescue scheme. Could 'encourage' actuaries, venture capitalists and employers, use moral suasion on the pensions industry to contribute as well as setting aside extra taxpayer resources as above.
3. If GMPs are taken care of, compensation for the rest of members' pensions could be paid at PPF levels (don't please quote me on this!)
4. Alternatively, stick with the FAS 80% level but make it tax free and inflation link payments.
5. We need a mechanism for members who have suffered severely, or can prove they read and relied on Government information, to be able to claim compensation from the DWP.
6. Members who could already have retired should receive their pensions – it is obvious that if they had known about the priority order, they would have retired and secured their pension, rather than staying at work and losing it all.
7. Tax free lump sums should be paid – this would make a big difference to many victims.
8. Improve spouse benefits – the FAS payments are pitiful. The Parliamentary Ombudsman report did not say taxpayers should be expected to fund the whole amount, but it is up to Government to *organise* the compensation, because Government is the only body realistically able to do so (as it did with Maxwell) and, in this case, Government is largely responsible for the injustice.

DETAILS

Government estimates that compensation would cost around £3billion in net present value terms - £15billion was not a realistic figure since cash costs are not relevant over long periods and also no allowance was made for the fact that all the pensions would be taxed and benefit expenditure would be reduced. The following could be part of a solution:

1. **Taking contracted out benefits back into state national insurance scheme for free** – as was the case with Maxwell - and paying the balance from the Financial Assistance Scheme. The Government issued an interest free loan to Maxwell trustees to cover the cost of buying back into the State scheme and paid the SERPS rights to all members. This is administratively easy to do, since every members' state pension statement shows how much is being deducted from their pension for their GMP (called the 'contracted-out deduction') so the figures are all known. It would, therefore, be perfectly possible, for this amount to be paid by the National Insurance pension service, as if the member had not contracted out. The National Insurance Fund is in surplus and would certainly be able to afford this. In fact, this would revert to the situation which prevailed before the 1997 changes which introduced the unworkable 'deemed buyback'. Putting all members back into the state scheme automatically would save enormous amounts of time and money for trustees and release extra assets to be used for members' pensions. Buying annuities for these GMPs is a very complicated and expensive exercise, due to the small amounts involved, different indexation requirements and complexity of the rules. Annuities purchased for this purpose are poor value.
2. **Unwind annuity deals.** Using scheme assets and topping up with public money for the balance – at an average cost of £100-£150million a year for about 50 years, was my original proposal back in 2003. Unfortunately, since then many trustees have bought annuities with the scheme assets. However, in theory, it would be possible to unwind these annuity deals and gather the assets together – perhaps alongside the Pension Protection Fund, or into the Financial Assistance Scheme (although it would be far more cost-efficient to use the PPF, rather than duplicating efforts) – and use them to pay pensions on an ongoing basis. For

example, ASW Sheerness had sufficient funds to pay full pensions to every member who would qualify for a pension for about 12 years after the company failed, but the trustees were not allowed to do so. Every scheme I have seen figures for would have had enough money to pay all pensions for at least 7 years, without needing another penny from other sources and that would give the Government time to organise a rescue.

3. **Paying lump sums to people with very small entitlements and transfer values to younger members**, would save administration costs and reduce the number of years over which compensation would need to be paid out.

4. **Use the Contingency reserve in National Accounts**

5. **Use unallocated sums in DWP budget.** About £100m a year is unallocated and could be set aside now and then more money could be raised in a trust fund over time.

6. **Conduct an investigation into actions of employers** whose companies failed, to see if there is any possibility of recovering monies

7. **Ask venture capital industry to contribute funds** as venture capitalists are responsible for a number of company failures where venture capitalists restructured companies and let subsidiaries fail along with their pension funds

8. **Consider asking for contributions from actuarial profession**, if it is thought they should have been more alert to warning trustees and members of risks

9. **Consider perhaps asking for voluntary contributions from banks, life companies, pension companies** and other sponsors with an interest in restoring confidence in pensions

10. **Sources of funds** – There are plenty of potential sources of funds, but the government will need to organise this. The monies could come from some or all of the following sources. Also, along the lines of the ‘Social Investment Bank’, these monies could be put into a special ‘Pension Replacement Fund’ designed to replace the lost pensions.

- a. Unclaimed assets in banks and building societies – estimate £400m
- b. Unclaimed assets in life policies - £1billion
- c. Unclaimed assets in pension policies – estimate £3billion
- d. Unclaimed assets in national savings – estimate £3billion
- e. Unclaimed dividends and shares – estimate £3billion
- f. Lottery funding – estimate £300m

How to organise a ‘Pension Replacement Fund’

Pool all the assets of winding up schemes perhaps into a fund called the ‘Pension Replacement Fund’ (PRF) which can run alongside the Pension Protection Fund, or as a separate division of the PPF. This new PRF would then receive extra funds from Government.

Independent trustees who are winding up the funds would continue to run the assets as now, until administration of the Pension Replacement Fund is in place. All members coming up to retirement age will start to receive their entitlements which will then be taken over by the Pension Replacement Fund once it is established.

Independent trustees will continue to administer the winding up schemes, but will not need to purchase annuities. Once the Pension Replacement Fund Board is ready to take over, there will be a transfer of assets and scheme records to this new Fund

If annuities have already been bought and cannot be unwound, or for members who have taken a transfer value out of the scheme, arrangements would be more difficult, but such members are surely entitled to the same help as others. The Board of the PRF will need to take actuarial advice to assess the amounts of lost pension to be restored to these members, which I would expect to be paid in the form of top-up pensions on an ongoing basis.