

Underpayments to Public Service Pensioners on Invalidity Benefit



This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

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Executive summary

Introduction

1 This report examines why around 50,000 public service pensioners (including retired nurses, teachers and local and central government staff) in receipt of Invalidation Benefit, had their occupational pensions incorrectly reduced in 1996. In particular, it considers why these changes were implemented and how the pensioners were treated, before the changes were deemed incorrect in 1997.

2 The report arose from a request from a Member of Parliament for an examination of the treatment of these pensioners. The National Audit Office examined the background to the events leading up to the decisions made, and the interaction between the Department of Social Security (the Department), the Benefits Agency (the Agency), the Treasury and public service pension schemes in the handling of these matters.

3 Our investigations involved an examination of papers held by the Department, the Agency, the Treasury, and Paymaster. We also had discussions with these bodies, with several public service pension schemes, and with the Pensions Ombudsman and the Parliamentary Commissioner for Administration, both of whom have received complaints from a number of pensioners about incorrect occupational pension payments.

Background

4 The state retirement pension is available at 60 for women and 65 for men. In addition, many people employed in both the private and public sectors contribute to occupational pensions. There are around 500 public service occupational pension schemes in the United Kingdom, providing for a wide range of current and former public sector employees. Members of these schemes (which are contracted out of the State Earnings Related Pension Scheme) receive their occupational pension in addition to any state pension.

5 Many people approaching retirement age receive state benefits. Some will have been in receipt of Invalidation Benefit (abolished in April 1995) or Incapacity Benefit (which replaced Invalidation Benefit)¹ as a result of being unable to work due to long term sickness or disability. Legislation provided that those in receipt of Invalidation Benefit had the option at state pension age to continue with the benefit instead of being paid the state retirement pension. Where they did this, their benefit entitlement was re-calculated so that it was the same amount as their individual state pension entitlement. This arrangement could last for a maximum period of five years, that is until compulsory state pension age (65 for women and 70 for men), at which point an individual was required by law to transfer to state retirement pension.

The advantages of receiving Invalidation Benefit instead of state retirement pension

6 One advantage of continuing to receive Invalidation Benefit after pension age for all recipients was that it was tax free, whereas tax might be payable on the state pension. However, this advantage was removed with the introduction of Incapacity Benefit, which is taxable. In addition, public service pensioners in receipt of Invalidation Benefit benefited from more favourable inflation proofing arrangements than those who received the state retirement pension.

7 Arrangements for those receiving state retirement pension at state pension age involve the payment of a basic pension and an additional earnings related pension, both fully inflation proofed by the Benefits Agency. With members of occupational pension schemes which are contracted out of the State Earnings Related Pension Scheme, the arrangements differ. Instead of all or part of the additional earnings related pension, these people receive an amount known as the Guaranteed Minimum Pension from their employer. Employers are generally not required by legislation to inflation proof all the Guaranteed Minimum Pension element of the occupational pension². Instead the Benefits Agency continue to pay inflation proofing on the whole of the state benefit as though the employee had not been contracted out. Thus the state pension includes inflation proofing for an amount equivalent to the Guaranteed Minimum Pension.

1 Invalidation Benefit was replaced by Incapacity Benefit in April 1995, although those in receipt of Invalidation Benefit at the time of the change and who were over state pension age continued to receive it until they reached age 65 (women) or 70 (men) under transitional arrangements. Entitlement to Incapacity Benefit normally ceases now at state pension age, although, in some cases, it can continue for up to a year thereafter.

2 On earnings from April 1988 schemes have had to pay the first 3 per cent on any inflation proofing of Guaranteed Minimum Pensions.

8 The arrangements for people in public service pension schemes who chose to remain on Invalidity Benefit after state pension age were more favourable. This was because as well as receiving state benefits at an identical rate to those on state retirement pension, including the inflation proofing of an amount equivalent to the Guaranteed Minimum Pension, they also had the whole Guaranteed Minimum Pension inflation proofed by law as part of their occupational pension. As a result, the Guaranteed Minimum Pension was effectively inflation proofed twice.

9 This more favourable arrangement continued until compulsory state pension age, when occupational pension schemes stopped paying any inflation proofing on all or part of the Guaranteed Minimum Pension. Thereafter, the pensioners experienced a drop in their income as a result of the loss of this inflation proofing and of the tax free status of Invalidity Benefit.

Key roles and responsibilities

10 The responsibilities in relation to the inflation proofing of public service pensions are shared between a number of bodies. These are as follows :

- The Department of Social Security are responsible for policy and legislation on the inflation proofing of the State Earnings Related Pension Scheme and occupational pensions generally (including the inflation proofing of Guaranteed Minimum Pensions). Other parties work within the context of this policy and legislative framework.
- The Benefits Agency pay inflation proofing on State Earnings Related Pensions. Effectively this includes all or part of the Guaranteed Minimum Pensions in payment by pension schemes. They also provide public service pension schemes with information to help them meet their statutory responsibilities for inflation proofing.
- The Treasury are responsible for legislation specifically concerned with the inflation proofing of public service pensions, and facilitate liaison between the schemes, and the Agency and the Department on operational matters. They also co-ordinate, draft, clear and circulate guidance on these matters.
- Public service pension schemes are responsible for paying public service pensions correctly and cost effectively, in accordance with the specific statutes and rules governing the schemes, as well as for informing their pensioners of their entitlements under these schemes.

- Paymaster are responsible for administering and issuing payments for 1.5 million public service pensions, under contract to central government public service pension schemes. (Local authorities usually make their own arrangements for administering and paying pensions.)

How underpayments to pensioners arose

11 The double inflation proofing of Guaranteed Minimum Pensions was sanctioned by a Ministerial Direction (a legally binding instruction provided for under the Social Security Pensions Act 1975), which also dealt with a variety of other issues, made in 1979. Over time, the Department, the Agency, the Treasury and the pension schemes lost sight of the relevance of the Direction in these particular circumstances. As a result, some confusion arose amongst these authorities about the legality of the practice of double inflation proofing. In early 1996, having received legal advice that overpayments had occurred, the Treasury relayed this information to schemes. Some 50,000 public service pensioners in receipt of Invalidity Benefit then had their occupational pensions reduced. It was later established that this understanding of the position was incorrect, and pension schemes were advised by the Treasury that pensions should not have been reduced in Invalidity Benefit cases. Where necessary, action is now being taken to reverse the adjustments. A more detailed chronology of these events is at Appendix 1. Further details of the roles of the organisations involved are given in Appendix 2.

Main findings

- 12** The main findings arising from our investigation are that:
- a) In 1979 officials from the former Civil Service Department and the (then) Department of Health and Social Security, meeting together in a joint working party with others from some public service schemes and the (then) Paymaster General's Office, considered that those receiving Invalidity Benefit were not in receipt of a pension. As a result, these people were not to be treated as formally retired for the purposes of the Social Security Acts. The working party, therefore, established that they were entitled to have their public sector pension fully inflation proofed. The Department put in place a two-stage computer notification process to provide schemes with the information they would need to assist them to do this.

- b)** Although pension schemes are responsible for advising members about changes in their occupational pension entitlements, the notification procedures, operated by the Benefits Agency and relied on by the pension schemes, were **confusing**. In particular, information contained in the second of two notifications, **appeared to contradict** information in the first notification.
- c)** On reaching 65 (for women) and 70 (for men), and thus no longer eligible for Invalidity Benefit, pensioners experienced a drop in their **income after tax** as a result of the loss of inflation proofing of **the Guaranteed Minimum Pension element of their occupational pension** and the tax free status of Invalidity Benefit. The Department and, after 1991, the Agency, did not take action to help pension schemes readily to identify pensioners in receipt of Invalidity Benefit and, therefore, enable them to notify those concerned that they would receive double inflation proofing initially, but that this would be removed later, on transfer to state pension. As a result, pensioners were not warned that this would happen.
- d)** Many public service pension schemes were, subsequently, unaware that double inflation proofing in Invalidity Benefit cases was the result of existing legislation. Some schemes were confused about members' entitlements and were concerned **about** whether they had made overpayments. During the 1980s this confusion was not a problem since the Department were aware of the basis for the arrangements.
- e)** Over time the Department, the Benefits Agency and the Treasury (which, in 1981, took on the former Civil Service Department's general interests in public service pensions) all lost sight of the legal basis for the double inflation proofing. Following evidence that some **local authority pension fund administrators** were removing the double inflation proofing in Invalidity Benefit cases, the Department received legal advice in February 1994. **This stated that there was no provision for the practice of double inflation proofing, and they then looked at ways to prevent it occurring.**
- f)** In the autumn of 1995 the Agency trawled the National Insurance computer system to identify all existing Invalidity Benefit cases. In consultation with the pension schemes and the Treasury, the Agency sent out **some 50,000 individual notifications to schemes in November 1995, advising them that they might wish to consider whether adjustments were required to "remove any double indexing which has occurred."**

- g)** In late 1995 a pension scheme brought the 1979 Ministerial Direction to the attention of the Agency, believing that it provided the legal basis for double inflation proofing. The Agency passed it on to the Treasury. As a result of changes in primary legislation since the original Direction, neither the Treasury and their legal advisers, nor the Department appreciated its significance.
- h)** After taking legal advice, the Treasury advised schemes in 1996 that overpayments had been made because of double inflation proofing. However, they gave permission to pension schemes administered by central government not to recover the 'overpayments'. Some local authority pension funds, though, took action, and thus some pensioners experienced extra hardship and distress to add to the unexpected reduction in their future pension payments.
- i)** The Agency received complaints or enquiries from pension schemes and pensioners, and enquiries from the Parliamentary Commissioner for Administration and the Pensions Ombudsman about overpayments. In response they stated that double inflation proofing could not be prevented because of Data Protection Act constraints. Legal advice obtained in 1994 confirmed that they could not reveal to schemes which pensioners were on Invalidity Benefit. Although this legal advice was correct, in practice this was not a problem because the notification arrangements agreed by the joint working party were designed to tell schemes when to carry out inflation proofing, without revealing confidential information. Explanations given by the Department and the Agency over time served to confuse and mislead the various individuals and organisations who made enquiries.
- j)** The Agency and pension schemes incurred significant additional administrative costs in removing double inflation proofing and in dealing with the many queries and complaints from pensioners and other parties when, in practice, there was no legal basis for this action. The overall cost which was levied on pension schemes is not known but, as an illustration, one major scheme told us that they had incurred administrative costs in excess of £300,000.
- k)** In August 1996 the Pensions Ombudsman asked the Agency to comment on the effect of the Ministerial Direction, and in particular whether pensioners receiving Invalidity Benefit were 'retired' for social security purposes. (The implication of this being that if they were 'retired' they should be treated the same as state retirement pensioners, who did not have double inflation proofing). The Agency took legal advice and stated in December 1996 that Invalidity Benefit pensioners "are to all intents retired from regular employment".

- l)** The Pensions Ombudsman did not agree with the Department's view, and reflected this in a provisional Determination on a complainant's case. Following receipt of the provisional Determination and a request for clarification of the legal position by the National Audit Office, the Department and the Treasury independently sought further legal advice. On the basis of this they concluded that their previous legal advice was incorrect and that pensioners in receipt of Invalidity Benefit and Incapacity Benefit were in practice entitled to full inflation proofing of both their benefits and their occupational pensions.
- m)** In 1997 the Treasury advised pension schemes that, on the basis of the Pensions Ombudsman's judgement and further legal advice, the action taken to reduce occupational pensions and recover 'overpayments' should not have been taken. They advised that corrections should be made to rectify the situation, and that any deductions should be refunded.
- n)** In July 1997 Treasury Ministers reviewed these arrangements and decided that the Ministerial Direction of 1979 should not be amended to remove the double inflation proofing in the case of Incapacity and Invalidity Benefit cases. This was on the grounds that the pensioners involved had already suffered considerable inconvenience, and that the number affected by double inflation proofing would fall rapidly and virtually disappear over the next few years.
- o)** During the latter part of 1997 and early 1998 the Treasury advised schemes that, where erroneous deductions from pensioners were reinstated, interest for late payment could be paid automatically, without waiting for claims to be made. They also advised schemes that they had discretion to award compensation for distress ('botheration') in all Invalidity Benefit cases. The Treasury's expectation is that schemes will meet additional administrative expenditure from their existing funding.
- p)** In January 1998 the Benefits Agency undertook a trawl of the National Insurance computer system to identify those pensioners on Invalidity Benefit and Incapacity Benefit originally notified to schemes as being potentially in receipt of double inflation proofing. Details were then passed to schemes to enable them to identify cases requiring reinstatement of earlier deductions and compensation for late payment.

Conclusions

13 Public service pension schemes are responsible for ensuring that pensioners receive the correct amount of occupational pension. However, in doing so the schemes rely on receiving prompt and accurate information from the Benefits Agency about the entitlement to, and the level of, the Guaranteed Minimum Pension. This information helps them in deciding the extent to which an individual's occupational pension should be inflation proofed.

14 In dealing with what they came to believe were overpayments to pensioners, the Department, the Agency, the Treasury and the pension schemes acted out of concern to avoid the incorrect and wasteful use of public funds. However, the lack of awareness of the underlying legal position amongst all of the parties in this matter, and the Department and the Agency's failure to address the wider interests of pensioners and public service pension schemes, led to unnecessary anxiety and hardship for significant numbers of pensioners involved, wasted effort on the part of pension schemes and unnecessary costs to the public purse. Further costs, amounting to several million pounds, will now be incurred in rectifying the mistakes made. As a result of the investigations by the Pensions Ombudsman and ourselves, some 50,000 pensioners should now receive the pension arrears to which they are entitled.

Recommendations

15 We recommend that the following action is taken urgently by the bodies named. We consider that:

- a) the Department and Agency should identify cases where pensioners may not have received their full pension entitlement as a result of the action taken by the Agency in 1995, and notify pension schemes of these cases so that they may remedy any underpayments. The Department have advised us that this action has now been completed.
- b) the Department and Agency should work with the Treasury to ensure that clear guidance is provided to schemes on the roles and responsibilities of the Treasury, Department, Agency and pension schemes in this area, and on the action schemes should take on the different types of notifications they receive from the Agency.

- c)** the Department and Agency should ensure that their notification procedures give schemes clear, accurate and timely information on individual Guaranteed Minimum Pensions, including in Incapacity Benefit cases, thereby enabling schemes to inflation proof their members' pensions correctly.
- d)** although confidentiality constraints prevent the Department from telling pension schemes that a particular individual is receiving a particular benefit, the Department and Agency should consider whether their standard guidance on state benefits explains sufficiently the broad circumstances in which social security benefits, and changes in them, may affect public service pension entitlements. Because only limited information is provided to schemes under the current notification arrangements, there may be occasions when pension schemes need further information on the state benefits paid to their members, in order to assess individual pension entitlements and likely further changes in these. All the parties involved should work together to review the options available to achieve this in a cost effective way.
- e)** the Department and Agency should consider, along with the Treasury, whether there are any lessons to be learnt, either from the problems arising from the inaccuracies in the legal advice in this case, or from the significance of the relevance of legislation being overlooked.
- f)** the Department and Agency should, in future, respond to pensioners' letters with full and accurate information in plain language about the arrangements for inflation proofing pensions and benefits, and what steps customers can take to have their complaints investigated and dealt with. This information should be in keeping with the principles of the Citizen's Charter and their own Customer Charter.

Main report

Background

1.1 The state retirement pension is available at 60 for women and 65 for men. In addition, many people employed in both the private and public sectors contribute to occupational pensions. There are around 500 public service occupational pension schemes in the United Kingdom, providing for a wide range of former public sector employees such as nurses, teachers and local and central government staff. Members of these schemes - which have opted to contract out of the State Earnings Related Pension Scheme - receive their occupational pension in addition to any state pension.

1.2 Many people approaching retirement age receive state benefits. Some will have been in receipt of Invalidity Benefit (abolished in April 1995) or Incapacity Benefit (which replaced Invalidity Benefit) as a result of being unable to work due to long term sickness or disability. Legislation provided that those in receipt of Invalidity Benefit had the option at state pension age to continue with the benefit instead of being paid the state retirement pension. Where they did this, their benefit entitlement was re-calculated so that it was the same amount as the state pension.¹ This arrangement could last for a maximum period of five years. That is until compulsory state pension age - 65 for women and 70 for men - at which point an individual was required by law to transfer to state retirement pension.

1.3 One advantage of continuing to receive Invalidity Benefit for all recipients was that it was tax free, whereas tax might be payable on the state pension. However, this advantage was removed with the introduction of Incapacity Benefit, which is taxable. In addition, one effect of a Ministerial Direction, made in 1979, was that members of public service pension schemes in receipt of Invalidity Benefit were entitled to receive both full inflation proofing of their occupational pensions (including the Guaranteed Minimum Pension element - the amount an employer guarantees to pay when an employee contracts out of the State Earnings Related Pension Scheme) and inflation proofing of the contributory element of their Invalidity Benefit (which after State Pension Age also included an amount

¹ When Invalidity Benefit was replaced by Incapacity Benefit in 1995, some people in receipt of the old benefit at the time of the change were entitled to continue to receive it under transitional arrangements. Entitlement to Incapacity Benefit normally ceases now at state pension age, although, in some cases, it can continue for up to a year thereafter.

equivalent to the Guaranteed Minimum Pension element). The latter was paid until 1991, by the Department of Social Security (the Department) and, after that date, by the Benefits Agency (the Agency).

1.4 This practice - referred to as 'double inflation proofing' - arose, in part, because Invalidation Benefit was not considered to be a pension. As a result, for a period of up to five years, until they were required to transfer to state retirement pension, those in receipt of Invalidation Benefit were at a financial advantage compared to those on a state pension. This was because, for these people, an amount equivalent to the Guaranteed Minimum Pension element of the occupational pension was inflation proofed by the Agency and by the pension scheme. For those on state retirement pension, this inflation proofing was only carried out by the Agency.² Figure 1 illustrates the impact of the decision to remain on Invalidation Benefit.

1.5 In 1996 some 50,000 public service pensioners in receipt of Invalidation Benefit had their occupational pensions reduced. In early 1997 it was established that the understanding of the position regarding Invalidation Benefit, which had led to the reduction, was incorrect. This followed complaints from pensioners, an investigation by the Pensions Ombudsman, a request for legal clarification by the National Audit Office and further legal advice. Action is now being taken to reverse earlier incorrect adjustments of payments to pensioners.

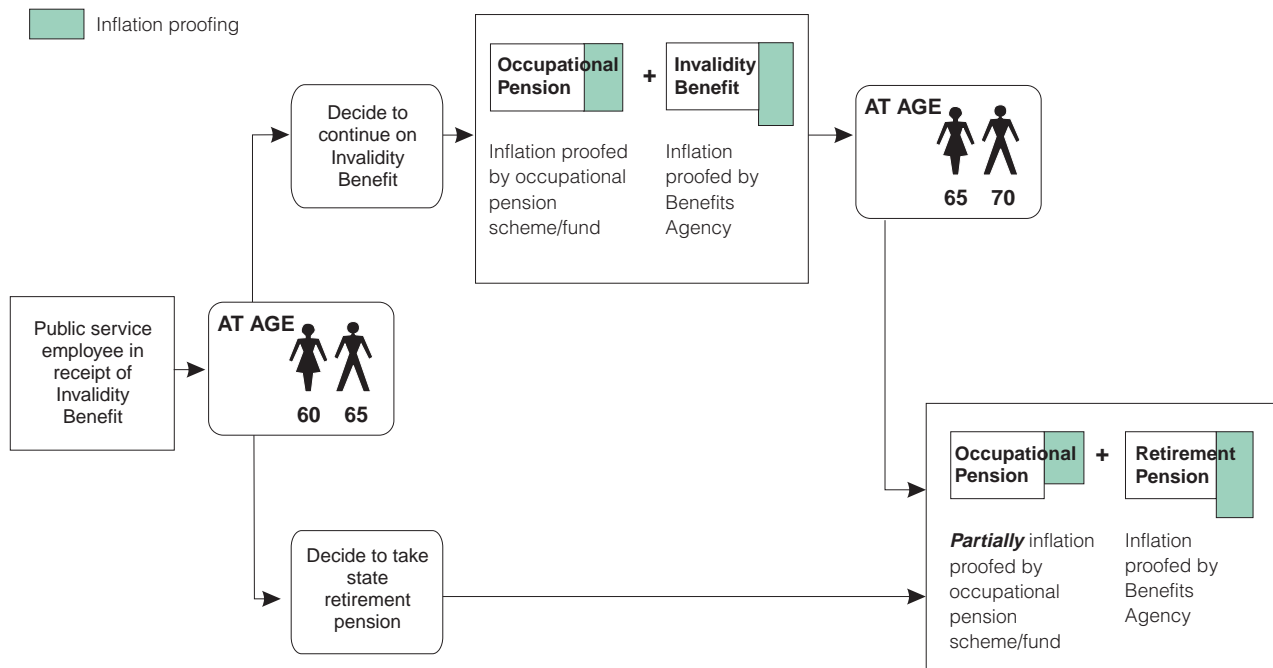
1.6 This report arose from a request from a Member of Parliament to investigate how these pensioners had been treated. It outlines the legislation and the roles of the parties involved, as well as the sequence of events which led to the removal and then the reinstatement of double inflation proofing. In particular, it focuses on what advice and information the Agency, the Department and the Treasury provided to public service pension schemes (paragraphs 1.12-1.31). It also examines how the Agency and the Department dealt with:

- Paymaster, which is responsible for making payments to pensioners on behalf of pension schemes (paragraphs 1.32-1.35);
- pensioners themselves in responding to complaints and enquiries

² On earnings from April 1988 schemes have to pay the first 3 per cent of any annual inflation proofing of Guaranteed Minimum Pensions.

Figure 1

The impact of continuing to receive Invalidation Benefit instead of state retirement pension



Note: Pensions scheme inflation proofing of Guaranteed Minimum Pensions up to 3 per cent on earnings after 1988 not included.

Figure 1 illustrates the financial advantage gained by continuing to receive Invalidation Benefit after minimum state pension age (60/65). This advantage arose from the full inflation proofing of both state benefit and occupational pension. On reaching maximum state pension age (65/70), when state retirement pension becomes compulsory, part of the inflation proofing of the occupational pension was removed.

- the Parliamentary Commissioner for Administration and the Pensions Ombudsman, who have both carried out investigations of complaints by pensioners (paragraphs 1.40-1.47).

The legislative background

1.7 All social security benefits and public service pensions are inflation proofed annually under various Acts. The legislation in force in 1979, when the Direction was first made was as follows :

- a series of Pensions Increase Acts (currently the Pensions (Increase) Act 1971) have long provided for inflation proofing of public service pensions;

- the Social Security Act 1975 provided for the annual inflation proofing of state benefits, including state retirement pension;
- the Social Security Pensions Act 1975 provided for inflation proofing to apply to the State Earnings Related Pension (the pension based on additional earnings above the basic state pension), paid as part of the state retirement pension;
- the Social Security Pensions Act 1975 also provided that those who were contracted out of the State Earnings Related Pension Scheme as members of an occupational pension scheme would effectively have their Guaranteed Minimum Pension inflation proofed by the (then) Department of Health and Social Security as if they were not contracted out; and
- to prevent double inflation proofing of the Guaranteed Minimum Pensions of public service pensioners (i.e. inflation proofing by the Department of Health and Social Security and by the occupational pension scheme), the Social Security Pensions Act 1975 also contained a provision requiring that the Guaranteed Minimum Pension be deducted from the public service pension before it was increased.

1.8 This latter provision created a number of anomalies in the operation of public service pensions, as a result of which some pensioners (such as those over state pension age, but for a variety of reasons, not receiving state retirement pension), were financially disadvantaged. To counteract this, the Act was amended subsequently to allow the Minister for the Civil Service to direct that, in some circumstances, the whole of the public service pension should be inflation proofed by the pension scheme. The objective was to ensure that these pensioners were no better or worse off after contracting out of the State Earnings Related Pension Scheme than before.

1.9 Under this provision, a Ministerial Direction was made in 1979. Officials from a number of bodies, in particular, the (then) Department of Health and Social Security, the former Civil Service Department (whose responsibilities in this area have since been taken on by Treasury), and a number of public service schemes, met together in a joint working party (chaired by the Department of Health and Social Security). The working party was set up to devise procedures to ensure that all public service pensioners received their full annual increases for inflation proofing. It confirmed that the Direction applied in cases where a pensioner chose

to remain on Invalidation Benefit, rather than transfer to state retirement pension. This decision was made on the grounds that Invalidation Benefit was not considered to be a pension.

The responsibilities of the parties involved

1.10 The responsibilities in relation to the inflation proofing of public service pensions are shared between a number of bodies. Their roles are as follows:

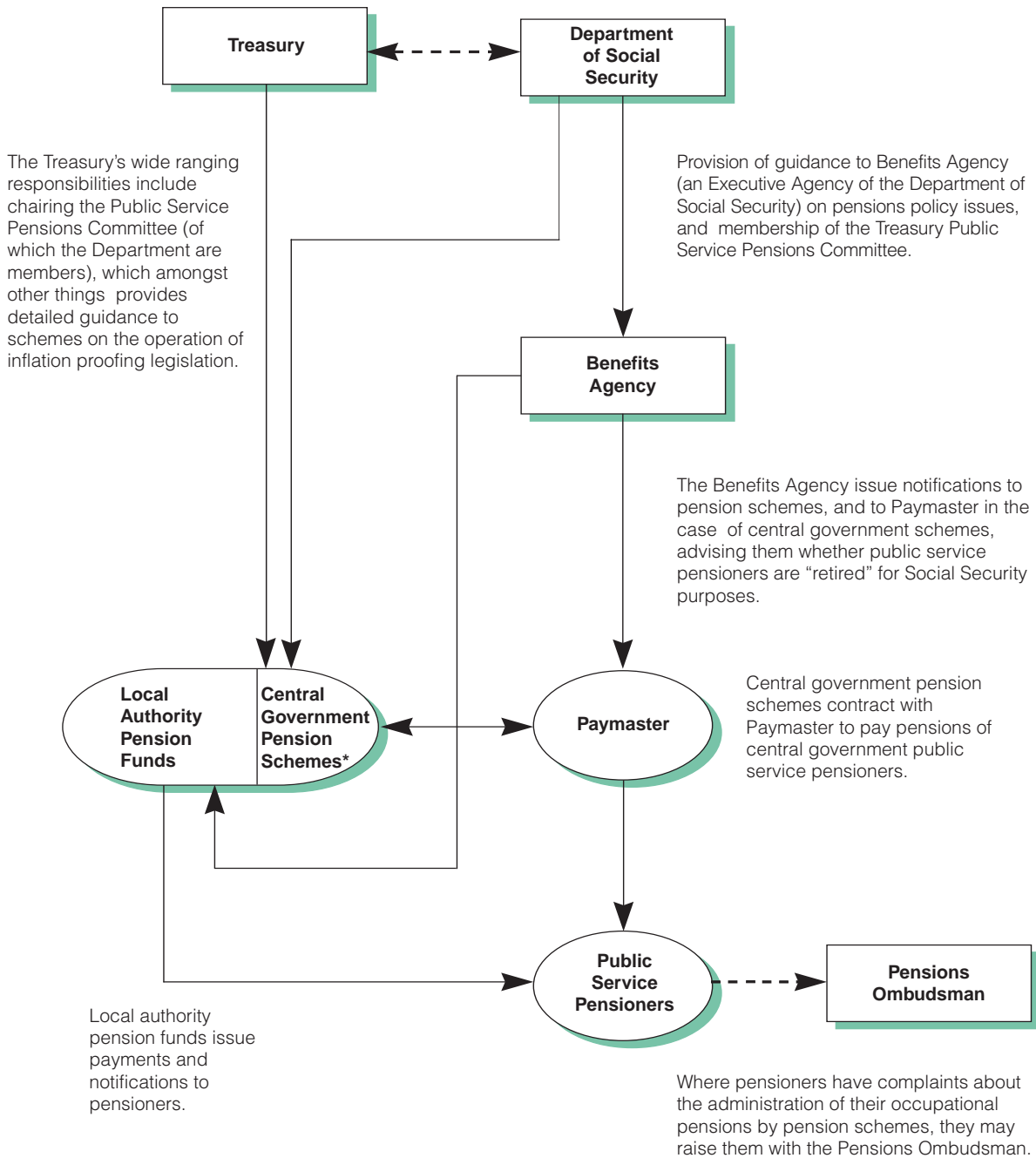
- Department of Social Security: responsible for policy and legislation on the inflation proofing of the State Earnings Related Pension and occupational pensions generally, including the inflation proofing of Guaranteed Minimum Pensions. Other parties work within the context of this policy and legislative framework.
- Benefits Agency: (an Executive Agency of the Department) pay inflation proofing on the State Earnings Related Pension, effectively including all or part of the Guaranteed Minimum Pensions in payment by schemes, as well as providing public service pension schemes with information to help them meet their statutory responsibilities for inflation proofing.
- Treasury: responsible for legislation specifically concerned with uprating public service pensions, and for facilitating liaison between the pension schemes, and the Agency and Department on operational matters, co-ordinating, drafting, clearing and circulating guidance on these matters.
- Public service pension schemes: responsible for paying public service pensions correctly and cost effectively, in accordance with the specific statutes and rules governing the schemes, and for informing their pensioners of their entitlements under these schemes.
- Paymaster: responsible for administering and issuing payments for 1.5 million public service pensions, under contract to central government public service pension schemes. (Local authorities usually make their own arrangements for administering and paying pensions).

The links between these organisations are summarised in Figure 2 and further details are at Appendix 2.

Figure 2

The relationships between the parties involved in the payment of public service pensions.

Liaison on aspects of the legislation on inflation proofing public service pensions.



* Includes departments with policy responsibility for pensions administered by local authorities.

1.11 A Treasury chaired committee provides a forum for schemes, together with the Department and legal advisers, to discuss a wide range of pensions matters, including pensions legislation and related issues and their impact on schemes' operations. The Treasury issue a Memorandum of Instructions on the operation of pensions increases for public service pension schemes, with information on the arrangements for notification and other matters relating to Guaranteed Minimum Pensions largely provided by the Department.

What the Department and the Agency told Public Service Pension Schemes

1.12 To help schemes implement the legislative requirements on inflation proofing, in 1983 the Department put in place computerised procedures to inform public service schemes of the retirement status of those entitled to an occupational pension, and how the level of the **Guaranteed Minimum Pension**, payable to those pensioners when they reached state pension age, compared with their entitlement under the State Earnings Related Pension Scheme. The procedures also notified schemes of any relevant changes affecting their members. Schemes used the information in these notifications to decide on the level of inflation proofing to provide. Guidance on inflation proofing the **Guaranteed Minimum Pension**, incorporating material provided by the Department, was issued by the Treasury, after clearance with the Department.

1.13 The Department's computer-issued notifications, read in conjunction with Treasury-issued guidance on inflation proofing, were designed to alert public service pension schemes as to whether they should inflation proof the whole or only part of the pension. One of the results of these procedures was that pension schemes could ensure that when public service pensioners reached state pension age, but continued to receive Invalidity Benefit, their occupational pensions were inflation proofed in full. And, on receiving a second notification when the pensioner transferred to state retirement pension, pension schemes could ensure that their occupational pensions were only inflation proofed in part. The detailed procedures are shown at Figure 3.

1.14 However, the computer-issued notifications in the case of Invalidity Benefit pensioners gave a **confusing** impression to pension schemes as to whether they should inflation proof the whole or part of the **Guaranteed Minimum Pension** in Invalidity Benefit cases. The first notification indicated that the pensioner was not retired, and thus signalled incorrectly that the Department were not inflation proofing the pensioner's state benefits, when in fact they were doing so. This was

Figure 3

The Benefits Agency's notification procedures

When the customer reaches minimum pension age and chooses to continue receiving Invalidation Benefit:

1. The customer's continued entitlement to Invalidation Benefit is recorded on the National Insurance computer.



2. The customer now receives Invalidation Benefit at a rate equivalent to the state retirement pension, fully inflation proofed by the Benefits Agency.



3. The National Insurance computer notifies the pension scheme that the pensioner is "NOT retired". This indicates to schemes that they should undertake full inflation proofing, including that of the customer's Guaranteed Minimum Pension.



4. The pension scheme inflation proofs the entire occupational pension.



Five years later when the customer reaches compulsory state pension age and must transfer to the state retirement pension:

1. The customer's status is recorded as "retired" on the National Insurance computer.



2. The customer now receives the state pension, fully inflation proofed by the Benefits Agency.



3. The National Insurance computer notifies the pension scheme that from the pensioner's 65th birthday (women) or 70th birthday (men) the Agency will take responsibility for paying inflation proofing equivalent to the Guaranteed Minimum Pension, **but with effect from the pensioner's 60/65th birthday.**



4. The pension scheme stops inflation proofing an amount equivalent to the customer's Guaranteed Minimum Pension.



Figure 3 shows the intended effects of the Benefits Agency's notification procedures (see paragraph 1.13). Unfortunately, the message contained in the second standard notification appeared to contradict the first notification. This led schemes to believe that the pensioner had been retired for five years and that the Agency had been inflation proofing the state retirement pension for that period. As a consequence, some schemes believed that they had made overpayments over the previous five years, and some tried to make recoveries.

apparently contradicted by the second notification, which led some schemes to believe that the pensioner had been retired for five years, and that the Agency had been inflation proofing the Guaranteed Minimum Pension for that period.

1.15 Many schemes were unaware that the prevailing legislation provided for double inflation proofing to pensioners in receipt of Invalidity Benefit. Therefore, on receiving the second notification, some queried whether an overpayment of occupational pension had occurred. In the 1980s the Department, at that stage aware of the history of the arrangements, advised them that this was not the case. Some schemes also pointed out that, although pensioners would suffer no loss through these procedures (because they had been at a financial advantage for five years), they would nevertheless experience an unexpected drop in income on transferring to state retirement pension. Schemes were concerned that they found it difficult to warn pensioners of this in advance, as, because of the data protection considerations (see paragraph 1.17), the Department's notification forms did not indicate specifically whether or not a person was receiving Invalidity Benefit. Within government, only the Department would have this information. Pensioners would, of course, have this information, but the notification arrangements were designed to achieve value for money across government as a whole and avoid schemes asking pensioners about their benefit status.

1.16 Over time, and possibly as a result of staffing changes and various amendments to the relevant legislation, officials in the Department and the Agency lost sight of the original legal basis for double inflation proofing. They came to view double inflation proofing as an incorrect, but unavoidable, by-product of inflexible computer operations which could not be amended cost effectively to take account of Invalidity Benefit cases. They believed also that the double inflation proofing had some form of Treasury approval. Officials considered that the problem would eventually disappear over a period of years with the replacement of Invalidity Benefit by Incapacity Benefit.

1.17 In the early 1990s an increasing number of local authority pension funds, also apparently unaware of the underlying legal position, came to the conclusion that overpayments of occupational pension had occurred. A number took recovery action, which came to the attention of the Agency. The Agency sought Departmental confirmation in November 1993 that double inflation proofing had Treasury approval, but the Department were unable to find any record of this and suggested that consideration be given to preventing it. In an attempt to avoid such 'overpayments' some schemes asked the Agency to inform them when pensioners

were receiving Invalidity Benefit. In early 1994 the Agency received legal advice stating that they would breach the Data Protection Act by revealing this information without permission from those involved.

1.18 The Agency's replies to pension schemes implied that, because of this, there was nothing the Agency could do to prevent 'overpayments' occurring. In practice, however, the constraints of the Data Protection Act would not have prevented the Agency from providing schemes with information that would have enabled them to avoid double inflation proofing, had that been necessary. The Department's automated notification procedures were designed to enable schemes to identify the cases where they should be providing full inflation proofing and when they should not. This was to be done in a way which would not breach confidentiality.

1.19 As a result of the level of concern and complaints following the action by some local authority funds to remove the double inflation proofing, and recover overpayments, and following enquiries from a pensions journalist, the Agency decided to review the justification for their procedures. In February 1994 they obtained legal advice that there was no provision for double inflation proofing. This led the Department to conclude that those schemes that were providing double inflation proofing were doing so incorrectly and thus spending public funds inappropriately.

1.20 In May 1994 the Department considered bringing the matter to the Treasury's attention in view of the fact that overpayments could go on until 2000. In December 1994 the Agency sent the Treasury a summary of their inflation proofing arrangements which referred to the fact that double inflation proofing occurred in Invalidity Benefit cases. The Department also reviewed the information the Agency gave to pension schemes, and concluded that it was misleading and inaccurate. The Department advised the Agency that they should not knowingly mislead pension schemes, but concluded that correcting this problem was an operational matter for the Agency to solve.

1.21 During the latter part of 1994 and the early part of 1995 the Department had contact with the Treasury over the more general, but related, issue of the late notification of details of individuals' Guaranteed Minimum Pension entitlements to pension schemes. As a result of the late notifications, both the Agency and public service pension schemes were effectively inflation proofing the Guaranteed Minimum Pension. This was leading to overpayments of pensions and was the subject of regular complaints from pension schemes and pensioners. The Treasury shared pensions schemes' desire to see action taken to identify and prevent cases

of double inflation proofing, and sought assurance from the Department that they would take action to improve their performance, including in cases where pensioners received Invalidation Benefit.

1.22 As part of their action to rectify these problems the Department confirmed to the Treasury in the summer of 1995 that the Agency would trawl their records to identify all existing Invalidation Benefit cases and issue letters to the schemes. This would enable the schemes, where they had not already done so, to make any necessary corrections to the rate of pension in payment. In consultation with the pension schemes and the Treasury, the Agency sent out some 50,000 individual notifications to schemes in November 1995, advising them that they might wish to consider whether adjustments were required to “remove any double indexing which has occurred”. They enclosed a statement to be passed on to pensioners who made enquiries. The letter and statement are set out on the next page.

1.23 The Agency had asked the Treasury to alert schemes to the fact that these notifications would be issued. The Treasury informed scheme representatives and the Department of the Environment (for the local authority pension funds), although some of these pension funds received no advance warning. In response to the letter, many schemes wrote to the Agency expressing concern that pensioners would blame them for what they regarded as an Agency error. They asked what measures had been taken to ensure that such a situation would not occur in future. The Agency’s replies to these letters did not fully explain their actions, and did not acknowledge any responsibility for the inconvenience caused.

1.24 On receipt of notifications from the Agency, some schemes took action to reduce the level of future pension payments. Some also attempted to recover what they now believed were overpayments of pension relating to earlier double inflation proofing. In late 1995 a pension scheme brought the Ministerial Direction to the attention of the Agency, believing that it provided the legal basis for double inflation proofing. The Agency forwarded the Direction to the Treasury but, due to changes in primary legislation since the original Direction, neither the Treasury and their legal advisers, nor the Department, appreciated its significance in this context. The Treasury advised schemes not to take action until they (the Treasury) had obtained legal advice. The Treasury were aware that attempts to recover overpayments caused problems for pensions schemes and were unsure whether overpayments had taken place here. In February 1996, the Treasury relayed to schemes the advice from their lawyers that there had been overpayments. Schemes then adjusted the pensions of Invalidation Benefit recipients.

1.25 Under Government Accounting guidelines central government schemes would normally have been obliged to pursue recovery of overpayments made in the previous twelve months, but on this occasion Treasury gave them authority to waive recovery action where they chose to do so. This resulted in some 20,000 'overpayments', totalling £3 million, being written off by departmental pension schemes in 1995-96, although as some schemes had difficulty identifying cases, the actual sums involved may have been higher. Local authority pension funds are not required to adhere to Treasury guidance contained in Government Accounting (they instead have to conform to the Audit Commission's Code of Practice with regard to writing off of losses), and it was left to them to decide what action they would take in these circumstances. No estimates are therefore available of either the total amounts written off or recoveries made.

1.26 In response to the action taken to adjust pensions, a number of complaints were made to the Pensions Ombudsman (see paragraphs 1.43 - 1.47). In the course of the Pension Ombudsman's enquiries into double inflation proofing during 1996, the Ministerial Direction was brought to his attention by a local authority pension fund as the basis for its action. In August 1996 the Pensions Ombudsman asked the Agency to comment on the effect of the Ministerial Direction. The Agency took legal advice and commented that Invalidity Benefit pensioners "are to all intents retired from regular employment", the implication being that if they were "retired" they should be treated the same as state retirement pensioners, who do not receive double inflation proofing. Despite this the Pensions Ombudsman concluded in a provisional Determination that double inflation proofing was a legal entitlement. As a result of this, and following our request for clarification of the legal issues, the Department and the Treasury both sought further legal advice which confirmed that the effect of the Ministerial Direction of 1979 was to provide for double inflation proofing in Invalidity and Incapacity Benefit cases. The action to remove the inflation proofing had thus been incorrect.

1.27 In January 1997 the Treasury advised schemes that adjustments made to reduce pensioners' payments as a result of earlier legal advice should not have been made, that corrections should be made to rectify the situation, and that any deductions made should be refunded. The Treasury also advised schemes that this could lead to claims for compensation for late payment. In the summer of 1997 Treasury officials sought ministerial opinion on whether the Direction should be amended to exclude Incapacity and Invalidity Benefit cases. Treasury Ministers decided against this as, within two years, there would be no remaining beneficiaries of Invalidity Benefit and these pensioners had already suffered considerable inconvenience. Ministers have also decided that existing

Benefits Agency letter to pension schemes following the change in notification procedures in 1995



To: xxxxxxxx Date: 1 November 1995
Pensioner xxxxxxxx NINO: xxxxxxxx
Scheme No: xxxxxxxx

The GMP liability notice which has been sent to you will have been annotated "Not Retired". You will in addition have a GMP/AP relationship statement noted "AP less than GMP". Based on this information you may have applied pension increases to the whole of the occupational pension including the GMP. You will wish to know however that since the GMP entitlement date DSS has, through SERPS:-

- * fully indexed all the GMPs which accrued before 6 April 1988;
- * Indexed, where appropriate, those GMPs which have accrued since 6 April 1988 by an amount in excess of the 3 per cent maximum which schemes are statutorily required to provide.

In view of this you will no doubt wish to consider the rate of pension in payment and whether or not to adjust it to remove any double indexing which has occurred. If you have any query about this letter, please write to DSS Longbenton or telephone xxxxxxxx.

Yours sincerely

Pensions Benefit Manager

Benefits Agency statement to pensioners following the change in notification procedures in 1995

"As you were contracted-out of the State Earnings Related Pensions Scheme (SERPS) your employer had to guarantee to pay an occupational pension at a rate no lower than you would have had if you had stayed in SERPS. This is known as a Guaranteed Minimum Pension (GMP) and is based on your National Insurance contributions.

When an employee, who has been contracted-out reaches state pension age (65 for a man/60 for a woman) we calculate Additional Pension (AP) as though the employee had stayed in SERPS. From this amount we deduct the GMP and pay any excess with State Retirement Pension (RP). The occupational pension scheme pays the GMP as part of the occupational pension.

Early April we increase the AP in line with price increases and deduct the GMP. The occupational pension scheme is only responsible for increasing the amount of their pension in excess of the GMP rate. As you remained on Invalidity Benefit (IVB) at State pension age instead of claiming RP, we advised the occupational pension scheme that you were not retired. Your rate of IVB from pension age is the rate of RP you would have received had you in fact claimed RP. This means that your GMP is being increased through the AP paid as part of your IVB.

We were unable to inform your pension scheme that IVB was in payment because of the confidentiality of our records and the provisions of the Data Protection Act. The scheme assumed from the information we gave it that you were not receiving any payments from the State scheme and so increased the whole of your occupational pension. As just explained however, your GMP was increased with your IVB and so you received the increase twice.

We have now informed your occupational pension scheme of the true position and they have had to recalculate your occupational pension to pay the correct amount that should have originally been paid. Your pension scheme would have been advised of the position when you claimed RP or reached age 70 (65 in the case of a woman), whichever is the earlier."

These letters contain only a partial and sometimes inaccurate explanation of events, and made it difficult for pensioners to understand why reductions in their pensions were being made. However, the letters reflected the Agency's position in relation to legal advice available at the time they were issued.

arrangements should not be changed, recognising that double inflation proofing would continue for a small number of recipients of Incapacity Benefit for part of a year after reaching state pension age.

1.28 In September 1997 the Treasury advised central government pension schemes that, where erroneous deductions were reinstated, compensatory interest for late payment should be paid automatically, without waiting for claims to be made.

1.29 In the course of finalising this report, we consulted several pension schemes. A number expressed concerns about the delays in being provided with information to enable them to take corrective action on pension cases, about how the administrative costs of these amendments and compensation to pensioners would be financed, and about the impact of undertaking additional work at a time when they are implementing the provisions of the 1995 Pensions Act.

1.30 In late 1997 and early 1998 the Treasury advised schemes on the alternative methods they might use for calculating interest on arrears owed to pensioners. Additional expenditure, including administrative costs, is likely to amount to several million pounds. The actual amount will depend on whether schemes decide to make compensation awards for distress ('botheration') in all cases. The Treasury's expectation is that schemes will have to meet any additional administrative costs that they incur from their existing funding.

1.31 In January 1998 the Benefits Agency undertook a trawl of the National Insurance computer system at the request of Treasury and schemes. The purpose was to identify those pensioners originally notified to schemes as being potentially in receipt of double inflation proofing. Details were passed to the schemes involved to enable them to identify cases requiring reinstatement of earlier deductions and the award of interest for late payment.

What the Agency told Paymaster

1.32 In 1995-96 much of the initial work administering the removal of double inflation proofing fell to Paymaster, the body responsible for making payments to pensioners on behalf of the majority of departmental public service pension schemes. The Agency did not inform Paymaster of their decision to run a computer trawl in 1995 to identify all remaining Invalidity Benefit recipients over state pension age, until after the necessary programming work had been commissioned. Normal practice was for Paymaster to receive pension notifications from the Agency on magnetic tape. On this occasion, however, the Agency

discovered, shortly before the trawl, that Paymaster would be provided with individual notifications in paper form. They advised Paymaster of this before the trawl was undertaken and offered to delay the work to allow amendments to be made to the program. Paymaster agreed to receive paper notifications because the Agency informed them that reprogramming would have held up notifications to all schemes for two months.

1.33 The Agency therefore, arranged for Paymaster to receive its share of the 52,000 notifications (some 22,000 items) on separate sheets of paper. As a result Paymaster had to sort and match clerically the notifications to pension records and input them manually to the computer system instead of doing a systems match. The extra work to recalculate the pensions occupied between 120 and 140 staff at Paymaster for about three weeks (a total of around 8,500 man hours), with the administrative costs charged to the public service pension schemes.

1.34 In addition, Paymaster told us that, on discovering that there had been reductions in their pensions, many pensioners initially contacted Paymaster in a distressed state. However, Paymaster had been advised by the Agency not to refer pensioners to the Contributions Agency's Contracted Out Employment Group or to Benefits Agency local offices. As a result, Paymaster's own Customer Service Teams had to offer what counselling they could in the absence of alternative official support.

1.35 In January 1998 the Agency ran a further trawl to identify cases where double inflation proofing had been incorrectly removed, to assist schemes in making corrections. On this occasion Paymaster requested paper notifications because each case required individual handling, owing to the input of interest for late payment. In the end, the Agency provided the information in both paper format and on magnetic tape.

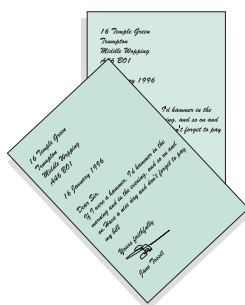
What the Agency told pensioners on Invalidity Benefit

1.36 When public service pensioners reached compulsory state pension age (65 for women, 70 for men) they ceased to be entitled to Invalidity Benefit and instead received an equivalent state pension. At this point, they were informed that they faced a drop in their income as state pension is taxable, whereas Invalidity Benefit was tax free. In addition, they also faced a further unexpected drop in income because they ceased to be entitled to double inflation proofing on the Guaranteed Minimum Pension part of their occupational pensions (See Figure 1).

1.37 The impact of removing the double inflation proofing varied for individual pensioners' circumstances, such as the length of the period for which they were contracted out of the State Earnings Related Pension Scheme and the level of earnings related National Insurance Contributions paid by the employee. Using a typical case provided by the Agency, we calculated that the pensioner's weekly entitlement would fall by £2.75. As a very broad guide to the relative value of this fall, the average annual occupational pension paid by one of the major pension schemes in 1996-97 was around £87 a week.

1.38 When pensioners received sudden reductions in their income and, in some cases, requests for repayments, many naturally wanted a full explanation. However, if they wrote to their pension schemes they were often advised to contact the Agency. This was because schemes regarded the problem as of the Agency's making. Schemes had also seen the Agency's letter to pensioners (on page 21) which stated that for further information pensioners should contact their pension scheme or the Department of Social Security. However, if pensioners wrote to the Agency they rarely received any explanation as to why their pensions had been reduced and were instead told that they should contact their pension schemes.

1.39 In responding to letters from members of pension schemes, Agency staff explained the problems in several different ways, referring to the constraints of the Data Protection Act, to operational problems with computer generated notification procedures, and to difficulties in finding a satisfactory solution to prevent double inflation proofing. Some letters also gave the misleading impression that the problem was an acceptable situation which the Department were prepared to live with, when in fact, they were at the time seeking to resolve it. The two examples below illustrate the difficulties pensioners experienced in obtaining a satisfactory explanation, their concerns about the effects of the Agency's actions on their financial position and the range of explanations offered.



Illustrative examples of pensioners' complaints and concerns

Example A gives extracts of a letter a local authority pension fund sent to a pensioner, explaining why his pension would be reduced. In addition, it gives extracts from the pensioner's letter to his Member of Parliament expressing concern about his treatment, and extracts from the Agency's reply to the Member of Parliament.

Example B contains extracts from a number of letters from a retired teacher to the Agency, seeking an explanation as to why his pension had reduced, as well as extracts from the Agency's replies.

Example A

In May 1996 a pensioner in receipt of Invalidation Benefit received a letter from his Local Government Pension Fund enclosing a copy of the Benefits Agency's standard letter (see paragraph 1.22). The Pension Fund commented:

1

Pensioner's comments

The pensioner asked his Member of Parliament to look into the matter, making the point that his pension scheme claimed that no blame could be attached to them. And he added:

2

" I also enclose a letter from the Benefits Agency which is written in terms which no ordinary English speaking pensioner could possibly be expected to comprehend. Whether this admits blame or not I would not know, but I do know that I am not to blame. So who repays the money?"

Benefits Agency reply

The Member of Parliament passed the letter to the Benefits Agency for comment. The Benefits Agency reply included the following:

3

Pension Fund Comments

"What this letter is saying in simple terms is that the Department of Social Security have made an error in your case and issued the County Council with an incorrect notification, instructing us to pay annual pension increases on that part of your local government pension represented by your Guaranteed Minimum Pension and that has caused us to overpay your pension.

Yours is not an isolated case, we have received approximately two hundred of these letters in this authority, and understand that the Benefits Agency have issued a large number of them nationally.

Your pension will have been overpaid with effect from the first award of pensions increase made subsequent to your attaining state retirement age.... and we are currently taking advice with regard to this matter.... Whilst I would stress that this error did not come from the action of the County Council, I do recognise the problems this situation can create and regret any inconvenience caused to you".



"As Mr ----'s occupational pension scheme was unaware that the DSS was inflation proofing his GMP, the scheme also increased the GMP to take account of inflation.

What has happened is that Mr ----'s occupational pension scheme has now been made aware of the true position and have recalculated the occupational pension. As a result, there has been a revaluation of his occupational pension. The level of Mr ----'s occupational pension, and any overpayment, is determined by the scheme and not the DSS. If he wishes to query how it has been calculated he should contact the scheme direct as only the scheme is in a position to advise him".

Example B

A pensioner in receipt of Invalidation Benefit wrote to the Benefits Agency in 1994 to ask why his pension had been reduced. Since then he has written over 13 letters to the Agency seeking to clarify the issue. The Agency have replied to each letter. The Agency's first two replies to the pensioner referred to operational problems with the Department's computer produced notification procedures and then went on to say:



The Agency later said that the situation had arisen because of the constraints of the Data Protection Act and, referring to its earlier statement about "operational problems", commented "This statement is not correct and does not refer to your circumstances and I apologise if it has misled you in any way".



Extracts from the pensioner's correspondence with the Agency included the following:

15 May 1995: The pensioner raised the point that he had been told on different occasions that double inflation proofing arose because "a satisfactory solution could not be found", that it was due to "operational problems with DSS computer produced notification procedures" and due to "the Data Protection Act". The pensioner commented:



"You may not have been able to advise Paymaster, but there seems no reason why you could not have advised me"... "I feel I am the unwitting victim of DSS's inability to talk to Paymaster. I think you would agree that your system is flawed. I have certainly been treated very unfairly, (what price the Customer's Charter now), and so it would not be unreasonable for the DSS to fund its own mistake".

30 August 1995:
The pensioner wrote:



"Surely you have a duty to show some concern towards the customer. Sadly lacking in my case. Did no one consider the financial position of the pensioner after a five year delay? Did no one take into account that I would be overspending my income, spending money I was not entitled to? (something I have never done in my life before), and that I could not know or possibly discover the situation I was being forced into".



"It was recognised some years ago that there was difficulty in preventing the double inflation-proofing of the GMP when a public service pensioner reached state pension age but continued to receive IVB. A satisfactory solution to prevent double inflation-proofing could not be found, and it was accepted that double inflation-proofing of GMP would take place until Retirement Pension replaced IVB....."

A public service pensioner receiving Invalidation Benefit from state pension age will therefore gain financially as opposed to the pensioner who received Retirement Pension from that age. That advantage ends however when the pensioner claims Retirement Pension because DSS is then able to notify the scheme that DSS have been increasing the GMP. This recalculation reduces the occupational pension to the level it would have been at had DSS been able to notify the scheme that it was inflation-proofing GMP from state pension age. While pensioners look upon this as a reduction in the occupational pension they are due, it is not. It is simply the ending of an advantage they have had over other public service pensioners".

Benefits Agency reply

23 July 1995: The Agency, in their reply, commented:



"I take your point that we could have informed you of the situation and from August this year we will be contacting each pension scheme to advise them of the situation in cases such as yours, although unfortunately this action comes too late to help yourself".

24 July 1996:
The pensioner wrote:



"Certainly your system is flawed and in my case I am sure Mr Mathison (**Head of the Benefits Agency**) would want to know. The pattern emerging from my correspondence shows very clearly the DSS was at fault even though it is very reluctant to admit it".

What the Agency told the Parliamentary Commissioner for Administration

1.40 Overpayments of public service occupational pensions, caused by the Agency's late notification to pension schemes of members' status with regard to state pension, were a problem throughout the early 1990s. In 1992 a fault with the National Insurance computer severely exacerbated this problem. In 1995 the Parliamentary Commissioner for Administration investigated complaints by three pensioners in receipt of Invalidation Benefit, who had been required to repay overpayments of occupational pension as a result of this fault, which had led to the Agency providing inadequate information to their public service pension schemes.

1.41 In response to the Commissioner's investigations, the Agency accepted that the 1992-93 computer fault had led to overpayments. However, they differentiated between these overpayments and the double inflation proofing which arose routinely in Invalidation Benefit cases, which they attributed to the constraints of the Data Protection Act (see paragraph 1.18). They told the Parliamentary Commissioner that "because of the confidentiality of the information held by the Department, and the provisions of the Data Protection Act, the Department cannot advise schemes when a person is receiving Invalidation Benefit. The Paymaster therefore inflation proofed the whole of the public service pension in the belief that the Department was not doing so".

1.42 The Parliamentary Commissioner's findings related specifically to overpayments of occupational pension which had been made **after** the pensioners had stopped receiving Invalidation Benefit and had begun receiving State Retirement Pension, and which had occurred as a result of the computer error. He found that the Department had been responsible for that error and that it had left pensioners with significant debts which they could not have foreseen. However, the Paymaster had agreed to write off all but the last 12 months' worth of overpayments, and to consider waiving recovery of the overpayments arising in the last twelve months also, if the pensioners could demonstrate that to repay that would cause hardship. The Parliamentary Commissioner accepted that the Paymaster's offer represented appropriate redress in the circumstances of the particular cases he had investigated.

What the Agency told the Pensions Ombudsman

1.43 Since 1995 the Pensions Ombudsman has received about 60 complaints from pensioners in receipt of Invalidity Benefit whose pensions have been reduced, and some of whom have been asked to make repayments. A number of these cases relate to late notification of Guaranteed Minimum Pension details to schemes, some of which were caused by the 1992-93 National Insurance computer fault mentioned in paragraph 1.40.

1.44 In August 1996 the Pensions Ombudsman asked the Agency to comment on the effect of the Ministerial Direction of 1979 on double inflation proofing of Invalidity Benefit paid after state pension age, and whether Invalidity Benefit pensioners should be considered “retired”. The Agency received legal advice in November 1996 to the effect that people receiving Invalidity Benefit after state pension age should be treated as “retired” for social security purposes. The implication of this was that if they were “retired” they should be treated the same as state retirement pensioners, who do not have double inflation proofing. In addition, the legal advice stated that there were “various related questions which might need to be discussed at some stage”. The Agency responded to the Pensions Ombudsman, somewhat briefly, that Invalidity Benefit pensioners “are to all intents retired from regular employment”.

1.45 In December 1996 the Pensions Ombudsman issued a provisional Determination on one case under investigation, which took the view that, in the light of the Ministerial Direction of 1979, no overpayments had occurred, no recovery action was due and that double inflation proofing was legal. This view contradicted earlier official legal advice taken by the Department and the Treasury.

1.46 In making a Determination on one complainant in March 1997, the Pensions Ombudsman commented that the advice given to pension schemes and pensioners by the Agency:

“has served, at the least, to confuse and mislead and at worst to result in underpayments of occupational pension, and to schemes recovering purported overpayments from pensioners. They were, evidently, at some point aware of the effect of the interaction of the Directions made by the Minister for the Civil Service with the Social Security Pensions Act 1975 and the Social Security Act 1975 and had then acted accordingly. By the time they wrote to the complainant in this case, confidentiality was given as a potential reason for increases being in effect payable twice, and it was implied that there had been an overpayment. By the time that they wrote to my office, it was again implied that schemes had made overpayments, and further that the information the Department had provided to schemes was wrong. It appears that it was at some stage decided (presumably in or around 1979) that double indexation was a necessary and unavoidable by-product of existing procedures. I have been unable to establish when or by whom. Since that time the original reasoning has been obscured by a haze of alternative explanations offered because Benefits Agency officers no longer knew why they had been acting as they had and so concluded that doing so was wrong. The Department of Social Security and the Benefits Agency may be outside my remit, but this does not prevent me from criticising them, which I do in the strongest terms”.

1.47 In the majority of cases investigated by the Pensions Ombudsman the scheme concerned was, not only directed to correct matters where necessary, but also to apologise and to pay compensation for distress and inconvenience. The compensation varied depending on the circumstances from £50 to £250. In those Invalidity Benefit cases where double inflation proofing has been withdrawn and he has made a Determination, the Pensions Ombudsman has generally awarded £100.

Appendix 1

Chronological summary of events

1	1978	Contracted-out pension schemes were introduced under the 1975 Social Security Pensions Act.
2	1979	<p>A Ministerial Direction was issued allowing for full inflation proofing of public service pensions in some circumstances. A Working Party of officials, chaired by the Department of Health and Social Security and with representatives from the Civil Service Department, the Paymaster General's Office, local authorities, Scottish Office and the Ministry of Defence, confirmed that the Direction applied to those in receipt of Invalidity Benefit after state pension age. The Working Party then determined what information the Department of Health and Social Security might give public service pension schemes to enable them to determine what level of inflation proofing they should provide.</p> <p>A Memorandum of Instruction was issued by the Civil Service Department on the application of pensions increases, including procedures for dealing with "not retired" cases. A copy of the Ministerial Direction was attached to the guidance. The Direction did not specifically mention the anomaly relating to Invalidity Benefit.</p>
3	1983	The Working Party produced revised guidance entitled 'The Operation of Pensions Increase Legislation'. A copy of the Direction was not attached.
4	1990	A revised Ministerial Direction was issued (although the provisions relevant to Invalidity Benefit cases did not change).
5	1992-93	A National Insurance computer fault, active from April 1992 to April 1993, was identified. The fault was found to have prevented notifications to public service pension schemes in 28,000 cases. The non-notifications were of all types, including Invalidity Benefit cases.
6	July 1993	The Agency's attention was drawn to the fact that some local authority pension funds were removing the inflation proofing from pensions where Invalidity Benefit was paid and recovering amounts already paid. This led the Agency to question the Department as to whether there was Treasury approval for full inflation proofing in these cases.
7	November 1993	Following requests from schemes, the Agency asked the Department whether there was provision for them to advise schemes when a person was in receipt of Invalidity Benefit.
8	February 1994	Legal advice stated that the Data Protection Act prevented the release of the information. In separate advice, lawyers also advised that they could find no basis for double inflation proofing. The Department concluded that a way should be found of ending it.
9	February 1994	The Treasury issued a revised Memorandum of Instruction on pensions increases in consultation with the Department. This did not mention Invalidity Benefit.
10	March 1994	The Agency sent notifications to public service pension schemes in respect of the 28,000 cases identified in item 5 above.
11	1994	Some schemes attempted to recover the overpayments arising from the Agency's late notifications. The Parliamentary Commissioner investigated complaints from three pensioners. These people had been overpaid because the Agency had neglected to inform the Paymaster, the administrator of their pension scheme, that they had stopped receiving Invalidity Benefit and had begun to receive state retirement pension. The Parliamentary Commissioner accepted that the Paymaster's offer to limit recovery to one year's overpayments, and to waive recovery altogether in cases of hardship, represented appropriate redress.

continued ...

Underpayments to Public Service Pensioners on Invalidity Benefit

12	1994	The Department and the Agency considered ways in which they could end the late notification and double inflation proofing problems relating to Invalidity Benefit cases. The Department considered it an operational problem relating to the provision of incorrect information to schemes by the Agency. The Agency considered it too late to make amendments to the National Insurance computer system and too costly to introduce a clerical sorting process. They considered that involving the schemes themselves to identify the individuals involved was the most appropriate solution to the problem.
13	1994	The Agency received complaints or enquiries from pension schemes, Members of Parliament and the Parliamentary Commissioner about the Agency's late notifications to public service pension schemes. The Department, Agency and Treasury discussed ways in which the Department's performance in respect of minimising the number of late notifications could be made.
14	December 1994	The Department mentioned the double inflation proofing problem arising with Invalidity Benefit cases to the Treasury for the first time.
15	April 1995	Invalidity Benefit was replaced by Incapacity Benefit.
16	November 1995	As part of their action to improve their service to pension schemes, the Agency ran a computer trawl to identify all cases where Invalidity Benefit was paid after state pension age. Some 50,000 were identified. The Agency notified all public service pension schemes that the Agency was undertaking inflation proofing in these cases. The Treasury advised schemes not to make adjustments until they had received legal advice. As a result of the trawl, the Ministerial Direction was brought to the attention of the Agency, who passed it on to the Treasury.
17	February 1996	Following legal advice that the Ministerial Direction did not seem relevant here, the Treasury advised pension schemes that double inflation proofing in Invalidity Benefit cases was incorrect and should be removed.
18	1996	Some local authority pension funds stopped double inflation proofing in Invalidity Benefit cases and some attempted to recover 'overpayments' from pensioners. Some pensioners complained to the Paymaster, the Agency and the Pensions Ombudsman.
19	March 1996	The Treasury advised central government pension schemes they need not recover 'overpayments', which could be written off.
20	April 1996	The Agency amended their notification forms to tell public service pension schemes as soon as possible when the Agency was undertaking inflation proofing in Incapacity Benefit cases.
21	August 1996	A Member of Parliament asked the Comptroller & Auditor General to investigate the case of a public service pensioner, whose local authority pension fund had attempted to recover what they had taken to be overpayments of pension.
22	August 1996	Following investigations, during which the Ministerial Direction was brought to his attention, the Pensions Ombudsman advised the Agency that, in his view, the 1979 Ministerial Direction provided for double inflation proofing in Invalidity Benefit cases. He asked for the Agency's comments, in particular, on whether people receiving Invalidity Benefit after normal state pension age should be regarded as "retired" for social security purposes. The Agency sought legal advice.
23	September 1996	The National Audit Office began investigations into the matter.
24	November 1996	The Agency received legal advice to the effect that people receiving Invalidity Benefit after state pension age should be treated as "retired" for social security purposes. The implication of this was that if they were "retired" they should be treated the same as state retirement pensioners, who did not have double inflation proofing. The advice also stated that there were "various related questions which might need to be discussed at some stage".
25	December 1996	The Agency informed the Pensions Ombudsman that people receiving Invalidity Benefit after state pension age should be treated as "retired" for social security purposes on the grounds that they were "to all intents retired from regular employment".

continued ...

26	December 1996	The Pensions Ombudsman issued a provisional Determination in which he said that double inflation proofing was not in fact illegal and that overpayments had not therefore occurred.
27	January 1997	The National Audit Office asked the Department to clarify the legal position.
28	January 1997	The Treasury concluded, on the basis of legal advice, that double inflation proofing was legal and that no overpayments had occurred. The Department's legal advice confirmed this in February 1997.
29	March 1997	A meeting was held between Treasury and Department officials to discuss the way forward. The Pensions Ombudsman issued a final Determination, recommending that the Benefits Agency "take all practicable steps to inform all wrongly advised parties of the true position, and ensure that the error is given publicity so that any schemes or pensioners not directly contactable are made aware of it".
30	August 1997	Treasury Ministers decided not to amend the Ministerial Direction to exclude Incapacity and Invalidity Benefit cases.
31	September 1997	The Treasury advised schemes that, where incorrect deductions had been reinstated, compensation for late payment should be paid automatically, without waiting for claims to be made.
32	November 1997	The Department's computer routines, which were amended in item 20 above to notify public service pension schemes that pensioners should be treated as "retired" when the Agency were undertaking inflation proofing in Incapacity Benefit cases, were returned to their original state.
33	January 1998	The Agency trawled its computer system to identify pensioners originally notified to schemes as potentially in receipt of double inflation proofing. Details were provided to schemes to enable them to identify cases requiring reinstatement of earlier deductions and interest payments for late payment.

Appendix 2

Roles of organisations concerned

The Department of Social Security

The Department of Social Security are responsible for the development and delivery of the Government's Social Security programme. The Department's headquarters supports Ministers on both policy and legislation, and provides corporate management, legal, statistical and analytical services to the Department as a whole.

The Benefits Agency

The Benefits Agency were established as an Executive Agency of the Department of Social Security in April 1991. The main business of the Agency is to process enquiries, claims, payments and changes of circumstances relating to recipients of over 30 separate social security benefits. The Agency have extensive dealings with statutory and voluntary bodies, local authorities, and other Government Departments.

The Treasury

The Treasury are responsible for formulating and putting into effect the United Kingdom Government's financial and economic policy. The Treasury's wide ranging responsibilities include policy on inflation proofing public service pensions, in the context set by the Department of Social Security's occupational pensions inflation proofing policy and practice. They also co-ordinate advice to and from public service pension schemes on the impact of legislation on their operations.

Paymaster

Paymaster provide a range of pensions administration and payment services. Payments are issued to more than 1.6 million public service pensioners and their dependants to the value of £8 billion each year. The banking services provide payments processing of some £800 billion a year on behalf of public sector bodies.

Paymaster were previously an Executive Agency from 1993 to 1997, and were bought by a joint venture formed by Electronic Data Systems (EDS) and Hogg Robinson Financial Services in April 1997.

The Pensions Ombudsman

The office of the Pensions Ombudsman was established in 1991. He has responsibility for investigating complaints, or resolving disputes, about occupational pensions. The Pensions Ombudsman also deals with complaints and disputes about some personal pension schemes.

The Office of the Parliamentary Commissioner for Administration

The Office of the Parliamentary Commissioner for Administration was founded in 1967. Its responsibilities are to investigate complaints about maladministration against Government Departments and certain non-departmental public bodies, referred to the Commissioner by Members of Parliament on behalf of members of the public. These include complaints that access to information under the 1994 Code of Practice on Access to Government Information has been wrongly refused.

Appendix 3

Invalidity Benefit and Incapacity Benefit

Invalidity Benefit

1 Invalidity Benefit was paid to the long term sick and disabled until it was replaced by Incapacity Benefit in 1995. Entitlement to Invalidity Benefit depended on the claimant having paid sufficient National Insurance Contributions, and having been incapable of work for 28 weeks during which he or she received statutory sick pay, sickness benefit, maternity pay or maternity allowance. Special rules applied for widows and widowers.

2 Invalidity Benefit was tax free and was made up of:

- Invalidity Pension, at the rate of basic state retirement pension, plus an **earnings related element** if claimants had paid sufficient National Insurance Contributions above the minimum rate;
- Invalidity Allowance, paid on top of Invalidity Pension to men under 60 and women under 55 in certain circumstances. Any **earnings related element** received reduced the amount of Invalidity Allowance.

3 Those over state pension age (60 for women, 65 for men) could continue receiving Invalidity Benefit if they deferred receiving their state retirement pension. An advantage of opting to continue with Invalidity Benefit was that it was tax free, whereas state retirement pension is taxable. In addition, recipients of Invalidity Benefit benefited from favourable inflation proofing arrangements. Entitlement to Invalidity Benefit thereafter lasted up to five years, **at which point**, recipients reached compulsory state retirement age (65 for women, 70 for men).

4 Invalidity Benefit was replaced by Incapacity Benefit in April 1995. Those already in receipt of Invalidity Benefit at that date could continue to receive it for up to five years, under transitional arrangements.

Incapacity Benefit

5 Incapacity Benefit replaced Invalidity Benefit in April 1995. During the first 28 weeks of incapacity the claimant must now satisfy the 'All Work' test. Entitlement depends on the claimant's National Insurance Contribution record, and can be claimed by employees excluded from Statutory Sick Pay, as well as by the self employed.

6 Short term Incapacity Benefit is payable at a tax free initial rate for the first 28 weeks, and thereafter at a higher taxable rate from weeks 29 to 52. Long term Incapacity Benefit is payable after 52 weeks of incapacity. An age addition is payable on top of the flat rate weekly payment. (There are two rates of age addition, the higher rate payable to those under 35 at the start of incapacity, and a lower rate payable to those aged 35-44).

7 Incapacity Benefit is not payable if the period of incapacity began after state pension age. Short term Incapacity Benefit is payable for up to 52 weeks if the period of incapacity began before state pension age and the claimant defers his or her retirement pension. Long term Incapacity Benefit is not payable after state pension age.