



National Audit Office

Review of errors in Guaranteed Minimum Pension payments

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SUMMARY

1 On 16 December 2008 the Government announced that five public service pension schemes had identified payment errors arising from the incorrect indexation, in some cases over many years, of an element of the pension known as the Guaranteed Minimum Pension. The five schemes concerned were those for the armed forces, civil service, judiciary, NHS, and teachers.

2 The Government also announced that the National Audit Office was to carry out a review of the payment errors, and this report presents the findings of our review. There are other public and private sector schemes which, because they are contracted out of the state second pension, should also take account of pensioners' Guaranteed Minimum Pension entitlements.

Our review is restricted to the five schemes specified in the Government's announcement in December 2008. The methods we used are set out in Appendix 1. The report sets out:

- the arrangements for uprating public service pensions and the Guaranteed Minimum Pension process (paragraphs 28 to 36);
- the extent of the payment errors and what went wrong with the Guaranteed Minimum Pension process to cause the errors (paragraphs 37 to 73); and
- why the payment errors were not prevented, the work done to identify and correct the errors, and the action taken to prevent errors recurring (paragraphs 74 to 109).

3 Public service pension schemes are contracted out of the state second pension, which is the earnings related element of the state pension. Employees forego their entitlement to a state second pension, but for service between 1978 and 1997 earned a 'Guaranteed Minimum Pension'. After state pension age, the occupational pension provided by the pension scheme must equal or exceed a person's Guaranteed Minimum Pension, thereby ensuring that people are no worse off because their scheme is contracted out. HM Revenue and Customs is responsible for calculating Guaranteed Minimum Pension entitlements based on information provided by employers on contracted out earnings, and for informing pension schemes of the entitlements of their members. Married women who paid reduced rate National Insurance contributions will not have Guaranteed Minimum Pension entitlements.

4 Prior to state pension age, public service pension schemes pay annual cost of living increases on the whole of a person's occupational pension. After state pension age, however, responsibility for paying increases on the Guaranteed Minimum Pension element is split between the pension scheme and the state. Overpayments occurred where pension schemes did not have Guaranteed Minimum Pension information recorded on their systems, and so continued to uprate the whole pension. The people affected therefore received part of the uprating in their Guaranteed Minimum Pension twice – once (correctly) from the state as part of their state pension, and once (incorrectly) from the pension scheme.

5 At the time of our report, the five pension schemes had identified overpayments totalling some £90 million to 85,509 people, and also a much smaller number of underpayments (Figure 1). The total number of people affected so far represents six per cent of scheme members over state pension age. The schemes are working to resolve some 26,000 further cases, which are not included in these figures, and expect final data to be available by August 2009.

6 The majority of people affected were overpaid and their corrected pensions for 2009-10 are lower than they would have expected. Despite the five per cent annual cost of living increase, 31,208 of the overpaid pensioners are receiving a lower pension in 2009-10 than they did in 2008-09. The smaller number who were underpaid are receiving, in 2009-10, money to which they were entitled in previous years.

7 The figures relate to pensions currently in payment, and the number and value of payment errors is therefore understated because the figures do not include errors in pension payments made over the years to people who died before the errors were corrected.

8 Where people opt not to claim state pension at state pension age, the pension scheme should suspend the usual Guaranteed Minimum Pension uprating rule, and continue to pay annual cost of living increases on the whole of a person's occupational pension. Our review of the Guaranteed Minimum Pension process also found a risk of underpayments to pensioners in this category (see recommendation (b)).

1 The number and value of the payment errors identified so far

Pension scheme	Overpayments		Underpayments		Total
	Number of cases	Value £	Number of cases	Value £	Number of cases
Armed forces	4,530	10,761,123	67	4,449	4,597
Civil service	18,833	19,483,376	3,922	146,251	22,755
Judiciary	191	265,275	71	4,937	262
NHS ¹	41,225	24,474,159	Data not available	Data not available	41,225
Teachers	20,730	35,190,708	857	35,518	21,587
Total²	85,509	£90,174,641	4,917	£191,155	90,426

Sources: Data supplied by the Ministry of Defence, the Cabinet Office, the Ministry of Justice, the NHS Business Services Authority and the Department for Children, Schools and Families

NOTES

1 Underpayment data was not available from the NHS scheme at the time of our report.

2 Schemes are working to resolve some 26,000 further cases, which are not included in this table.

9 The process for providing pension schemes with Guaranteed Minimum Pension information also depends on HM Revenue and Customs and the Pension, Disability and Carers Service, who in turn rely on information from employers. The end-to-end process is complex and can break down at a number of points. In simple terms, however, there are two scenarios which led to the pension schemes not having Guaranteed Minimum Pension information recorded for some of their members, leading to the payment errors (**Box 1**).

10 The pension schemes are responsible for making payments to pensioners in accordance with the rules governing their schemes, and for obtaining the information necessary to calculate payments correctly. Although they can seek to recover money that is paid incorrectly, the schemes bear the financial risk of payment errors and need to manage this risk through having adequate checks and controls, including over the completeness and accuracy of data.

11 Prior to the discovery of the payment errors, the schemes assumed that the Guaranteed Minimum Pension process was working as intended, and that the information they received from HM Revenue and Customs

was complete. No checks over the completeness of information were in place, despite the complexity of the process and previous concerns about how effectively it was working. For example, as far back as the mid 1990s the schemes had raised concerns about the process leading to overpayments, and an independent report to Government in 2002 had highlighted the complexity of arrangements surrounding Guaranteed Minimum Pensions. Not all parties directly involved in the process were familiar with the guidance note on administering Guaranteed Minimum Pensions which is, in any case, now out of date. The latest version of the guidance note was issued by HM Treasury in 2001, and was based on advice provided by the then Department of Social Security.

12 The pension schemes, their payment contractors and HM Revenue and Customs have carried out extensive work to identify missing Guaranteed Minimum Pension information and deal with the payment errors. The schemes plan to write off the overpayments as it was considered that action to seek recovery was unlikely to be cost-effective, and the arrears resulting from the underpayments are to be paid to pensioners. From April 2009, most pensioners have been paid the correct pensions, with the remainder due to be corrected by August 2009.

BOX 1

Scenarios which led to the pension schemes not having Guaranteed Minimum Pension information recorded for some of their members

HM Revenue and Customs did not issue a Guaranteed Minimum Pension notification to the pension scheme

Where a person remains in contracted out employment up to state pension age, the issue of a Guaranteed Minimum Pension statement relies on the Pension, Disability and Carers Service feeding back to HM Revenue and Customs information received from employers as part of the process of finalising state pension claims. If claims are not finalised or not finalised properly, however, there is no trigger for HM Revenue and Customs' National Insurance Recording System to issue a Guaranteed Minimum Pension statement to the pension scheme.

A review by HM Revenue and Customs in April 2008 confirmed the correctness of the Guaranteed Minimum Pension notifications issued by the National Insurance Recording System. However, the review did not provide assurance that all Guaranteed Minimum Pension notifications that should have previously been issued had in fact been issued, as the System does not currently have the functionality to confirm the production of individual notifications for past periods.

The Guaranteed Minimum Pension notification was sent to the wrong pension scheme or was not matched to a record on the pension scheme's payment system

The main reason for pension schemes returning Guaranteed Minimum Pension notifications is that the person's record in the National Insurance Recording System includes an incorrect scheme reference number, and the notification is therefore sent to the wrong scheme. The reference number is provided to HM Revenue and Customs by the Pension, Disability and Carers Service, pension schemes, or employers.

In addition, pension scheme payment contractors may be unable to match notifications to a record on their system where they have no record of the person because the occupational pension award has not yet been processed by the scheme administrator.

Some notifications in 2002-03 were not matched to pension scheme records due to system formatting differences and, during recent work to identify and correct the errors, some of the same cases were still found to be missing Guaranteed Minimum Pension information.

Guaranteed Minimum Pension statements that are rejected should be returned to HM Revenue and Customs. However, neither the pension schemes nor HM Revenue and Customs have kept records to track rejected notifications and how they were dealt with. There is therefore no assurance that all notifications have ultimately reached the correct pension scheme.

13 Work is now under way to develop proposals aimed at preventing the errors recurring, but this work remains at a very early stage and it is too soon to take any assurance that the underlying causes have been addressed. No one party will be able to prevent a recurrence of the errors, and changes will require the commitment of all those involved. The pension schemes recognise that they need to be more proactive in seeking to ensure that they hold all Guaranteed Minimum Pension information. In addition, HM Revenue and Customs and the Pension, Disability and Carers Service are working together to review their processes and communications to identify improvements that can be made.

Concluding comments

14 The process for notifying pension schemes of Guaranteed Minimum Pension entitlements is complex and fragmented, and therefore prone to error. There was a collective failure to recognise the interdependencies between the parties and the potential for the process to break down. The successful administration of the Guaranteed Minimum Pension process required effective joint working, but the parties failed to achieve it.

15 The Guaranteed Minimum Pension process involves the pension schemes and their payment contractors, but also relies on HM Revenue and Customs and the Pension, Disability and Carers Service, who in turn rely on employers. No one party owns the process as a whole and no one took responsibility for checking it was working properly or for ensuring that problems were satisfactorily resolved when, for example, pension schemes could not match Guaranteed Minimum Pension notifications to their systems. There was no assurance therefore that the information passing between HM Revenue and Customs and the pension schemes, and between the Pension, Disability and Carers Service and HM Revenue and Customs, was complete. Despite the complexity and the known history of problems, the process lacked checks and controls, which meant that the missing Guaranteed Minimum Pension information and the resultant payment errors went undetected, in some cases for many years.

16 The payment errors resulted from the Guaranteed Minimum Pension process breaking down in a number of ways, leading to the pension schemes not having Guaranteed Minimum Pension information recorded when they should have done. Responsibility for the errors is shared between:

- the pension schemes and their payment contractors, for neglecting to put in place checks that they had obtained the information necessary to calculate payments correctly. Specifically, they did not make sure that the Guaranteed Minimum

Pension information they held was complete and did not have adequate arrangements for tracking rejected notifications;

- HM Revenue and Customs, for failing to have adequate arrangements for tracking Guaranteed Minimum Pension notifications which were rejected and returned by the pension schemes, and for having no checks built into the National Insurance Recording System to reduce the risk of notifications being sent to the wrong pension scheme; and
- the Pension, Disability and Carers Service, for not always finalising state pension claims either at all or properly, meaning there was no trigger for HM Revenue and Customs to issue a Guaranteed Minimum Pension notification, and for supplying incorrect scheme contracted out numbers to HM Revenue and Customs, meaning that notifications were sent to the wrong pension scheme.

Recommendations

17 Without co-ordinated action by all parties to improve the Guaranteed Minimum Pension process, there will be duplication of effort and potentially inconsistent new standards and approaches adopted. Our detailed recommendations at (b) to (l) should therefore be addressed in the context of the urgent resolution of recommendation (a), which concerns responsibility for the process as a whole and leadership of actions necessary to improve.

- a **The Guaranteed Minimum Pension process involves several inter-dependent parties who failed to work together effectively. At present, none of the parties has a lead responsibility for the process as a whole.** HM Treasury, HM Revenue and Customs, the Pension, Disability and Carers Service and the five pension schemes should agree the one body which will be responsible for the Guaranteed Minimum Pension process as a whole, and for oversight and co-ordination of plans to address weaknesses in the process. The decision on where this responsibility falls is not an easy one but, in our view, it should be either the Pension, Disability and Carers Service or the Cabinet Office. The Pension, Disability and Carers Service is the body most directly connected to the pensioners who are affected by administrative failings concerning Guaranteed Minimum Pension, and to the overall quality of government services to pensioners. The Cabinet Office is the body which, amongst the departments responsible for paying public service pensions, is the one which has been most closely involved in co-ordinating actions to deal with the payment errors, and which also has the role of strengthening the civil service as a whole.

18 We acknowledge the extensive work that has been carried out so far to identify and deal with the payment errors. Our review also identified two further risks which should be addressed by the parties as part of this work.

- b** **There is a risk that pension schemes may be underpaying members who left contracted out employment early but who have deferred claiming state pension. It is not clear how the pension schemes know whether these ‘early leavers’ have claimed state pension and, if not, that the scheme should therefore suspend the usual Guaranteed Minimum Pension rules and uprate the occupational pension in full.** Working with HM Revenue and Customs and the Pension, Disability and Carers Service, the pension schemes should confirm whether members in this category are in receipt of state pension, and take action to both correct any underpayments that have arisen and to address the risk of underpayments in the future.
- c** **There is a risk that payment errors will continue to occur after the correction exercise during 2008-09, but before actions to prevent errors recurring have been agreed and implemented.** Working with HM Revenue and Customs, the pension schemes should check whether there are any further overpayments or underpayments which were not captured by the correction exercise during 2008-09, and take any necessary corrective action.

19 Going forward, we make the following recommendations to help strengthen the Guaranteed Minimum Pension process.

On improving the overall management of the process

- d** **The lack of checks and controls over the Guaranteed Minimum Pension process as a whole fails to take account of the complexity of the process and the history of concerns and known problems.** The pension schemes, HM Revenue and Customs and the Pension, Disability and Carers Service should review the checks and controls in place over the process, both within their organisations and over the exchanges of information between them.
- e** **There is little management information in respect of key aspects of the Guaranteed Minimum Pension process.** The pension schemes, HM Revenue and Customs and the Pension, Disability and Carers Service should collect information to help them monitor key parts of the process, for example, on the finalisation of state pension claims, the accuracy of scheme contracted out numbers, and the clearance of rejected Guaranteed Minimum Pension statements.
- f** **Pension schemes remain concerned about the completeness of the Guaranteed Minimum Pension notifications generated by the National Insurance Recording System.** HM Revenue and Customs should identify how it can provide greater assurance about the completeness of the outputs from the National Insurance Recording System. The pension schemes should implement procedures to identify members who have reached, or are soon to reach, state pension age but for whom they do not have Guaranteed Minimum Pension information recorded on their systems.
- g** **The pension schemes’ payment contractors were required under the terms of their contracts to calculate and pay pensions correctly, and to do so the contractors need to obtain Guaranteed Minimum Pension statements. However, under the existing arrangements responsibility for the non-receipt of Guaranteed Minimum Pension statements was not always clear, and therefore the pension schemes agreed to pay them additional amounts to rectify the resulting payment errors.** At the earliest opportunity, pension schemes should amend contracts to make explicit the extent of their contractors’ obligations for securing complete details of Guaranteed Minimum Pension entitlements, and should subsequently monitor the performance of contractors in this regard.
- h** **The responsibilities of the different parts of government involved in the Guaranteed Minimum Pension process, and the levels of service they can expect from each other, have not been set out.** Pension schemes, HM Revenue and Customs and the Pension, Disability and Carers Service should agree and document their specific responsibilities, including service standards for the provision of timely and complete Guaranteed Minimum Pension information, and responsibilities for checking that the process as a whole is working properly.

- i The guidance on administering Guaranteed Minimum Pension entitlements is out of date, and not all the parties directly involved in the process were familiar with the guidance. HM Treasury, the Pension, Disability and Carers Service, HM Revenue and Customs and the pension schemes should collectively develop and agree new guidance, promote it to staff, and then regularly review and update it as necessary.
- j Action to prevent the payment errors recurring will require the commitment of all parties involved in the Guaranteed Minimum Pension process, but there is currently no forum which brings them together. Strengthening the process requires the pension schemes to be more proactive and all parties to work more closely together. The pension schemes, their payment contractors, HM Revenue and Customs and the Pension, Disability and Carers Service should come together to agree detailed proposals for improvement, a timetable for their implementation, and arrangements for monitoring the effectiveness of the action that is taken.
- I The complexity of the existing Guaranteed Minimum Pension system increases the risk of error and makes it costly to administer. A complicated administrative process has evolved over a number of years, in a context of changing legislation and organisational structures. A fundamental review should therefore be commissioned to consider whether, within the existing legislation in respect of Guaranteed Minimum Pensions, there are opportunities to reform and simplify the administrative system designed to implement that legislation. We suggest the review should be commissioned by HM Treasury because of its responsibility for the financial and budgetary framework and for ensuring departmental efficiency, together with the Cabinet Office as the central co-ordinator of the response to these errors and with its wider responsibilities for the civil service.

On simplifying the process as a whole

- k Guaranteed Minimum Pensions were earned between 1978 and 1997 and are no longer accruing, meaning that the existence of entitlements is known and will not change. While the base Guaranteed Minimum Pension is re-valued each year up to state pension age, pension schemes could annotate members' records with Guaranteed Minimum Pension information in advance of their reaching state pension age, rather than waiting for HM Revenue and Customs to provide notifications. Pension schemes and their administration and payment contractors should assess whether prior annotation offers a cost-effective way of reducing the risks associated with administering Guaranteed Minimum Pensions.