



National Audit Office

Report

by the Comptroller
and Auditor General

Government Actuary's Department

Investigation into Police and Firefighters' Pension Scheme commutation factors

What this investigation is about

1 In May 2015, the government recognised a liability of £711 million relating to the underpayment of lump sums received by an estimated 34,000 individuals who retired from the Police and Firefighters' Pension Schemes between 2001 and 2006. This equated to an average payment of £21,000 per pensioner, between 5% and 36% of the value of the pension lump sums they received initially. This liability arose because of the collective failure by government to understand its statutory obligations for the administration of the schemes; and to recognise that the formula that was used to convert annual pension payments to lump sums should have been updated between 2001 and 2006. This failure was judged by the Pensions Ombudsman to amount to maladministration in 2015, between 9 and 14 years after the affected individuals retired. Following the Ombudsman's judgment, the majority of individuals received compensating payments by 31 March 2016, but some complex cases did not get resolved until the 2016-17 financial year.

2 Public sector occupational pension schemes cover staff working in central government (for example in the civil service and NHS), local authorities and arm's-length bodies including public corporations. The largest schemes in central government, including the Police and Firefighters' Pension Schemes that are the focus of this report, are unfunded. Unfunded schemes operate on a pay-as-you-go basis, whereby contributions from current employees and employers are used to pay current pensioners their pensions. The Police and Firefighters' Schemes include provisions for commutation. This is the process by which an individual sacrifices a portion of their future pension payments, in exchange for an 'actuarially equivalent' lump sum.¹

3 In May 2015, the Pensions Ombudsman upheld a test case on the appropriateness of the 2001 to 2006 commutation provisions against the Government Actuary's Department (GAD). In its judgment on the test case, the Ombudsman found maladministration in relation to GAD's role in the calculation of commutation factors for the Firefighters' Pension Scheme. The Ombudsman's ruling also indicated that its conclusion on the test case should set the terms for a broader settlement of similar cases across the Firefighters' and Police Pension Schemes.

¹ The majority of these commutation payments are tax free, however, they may incur a tax charge dependent on the individual's circumstances.

4 This investigation describes the chain of events, set out in Appendix One, which led up to the Pensions Ombudsman's decision. In particular we identify the role of government and its advisers from the failure to understand the statutory responsibilities for updating commutation factors between 2001 and 2006; through the initial commutation payments; the legal challenges that the government faced and instigated; and resolution of the claims in 2015-16 and into 2016-17. We set out the reasons for the time taken to resolve the position throughout the process; and identify those actions that are relevant to broader consideration of similar cases in the future. The investigation does not examine the evidence in support of the test case or the judgment reached by the Ombudsman.²

5 Part One of the report sets out the roles and responsibilities in relation to the management of the Police and Firefighters' Pension Schemes. Part Two sets out the key events in the lead-up to the Ombudsman's decision and the implications for the individuals concerned. Part Three sets out the government's response to the claims made; and Part Four describes the governance processes that were in place at the time and their relevance to the case.

2 These are set out in the Ombudsman's judgement which can be found at: www.pensions-ombudsman.org.uk/wp-content/uploads/PO-1327.pdf

Summary

Key findings

- 1 The government failed to provide appropriately valued pension lump sums for an estimated 34,000 police and firefighters.** Following complaints by pensioners, the government was aware in 2006 that the commutation factors used to calculate police and firefighters' pension lump sums did not reflect the life expectancy of pensioners or the underlying trends across pension schemes for payments made before 2006 (paragraphs 2.29 and 2.34).
- 2 The Pensions Ombudsman (the Ombudsman) upheld the pensioners' complaints in 2015.** The majority of pensioners received corrective payments, including interest to compensate for the time that elapsed, within 10 months of the Ombudsman's ruling. However, this meant that some individuals had retired for over 15 years before they received their full pension entitlement (paragraph 2.29).
- 3 The total value of payments to the affected individuals is estimated to be £711 million, an average of £21,000 per pensioner.** This equates to increases of between 5% and 36% of the lump sums the pensioners received initially (paragraph 2.34).
- 4 Government's statutory responsibilities in relation to the review of commutation factors were not sufficiently understood in the period leading up to the pensioners' complaints.** In the 2001 to 2006 period, the Government Actuary's Department (GAD); which is overseen by HM Treasury; the Home Office; and the Department for Communities and Local Government (DCLG), did not adequately consider their collective responsibilities for oversight of the factors; and whether they provided lump sums that were equivalent to the pension payments the individuals agreed to surrender (paragraphs 2.4 to 2.10).

The timeline

Identifying the failure to update the commutation factors

- 5 The initial query about the appropriateness of the commutation factors that were applied in the 2001 to 2006 period was raised by the Office of the Deputy Prime Minister (ODPM), now known as DCLG, in 2002.** GAD was aware that the factors did not reflect the life expectancy of pensioners or the trends across similar pension schemes by April 2004. This is shown in documentation and emails that were available at the time that evidence the discussions between GAD, the ODPM and the Home Office (paragraphs 2.6 and 2.7).

6 GAD started to commission reviews of the appropriateness of the commutation factors in 2005 and scheme members initially raised concerns regarding the appropriateness of the factors in 2006. This started the process of establishing whether the commutation factors were significantly out of line with the life expectancy of scheme members, which affects the assumptions used to calculate pensioners' lump sums (paragraph 2.11).

7 Following internal consideration of the concerns raised by pensioners, GAD updated the commutation factors for the Police and Firefighters' Pension Schemes in December 2006. At this point the government was aware that the factors had not changed between the time they were last updated in 1998 and 2006 and had increased during the period (paragraph 2.11).

8 The government decided to test its liability through the courts. The government received legal advice from the Government Legal Department, previously known as Treasury Solicitors, which supported GAD's decision to pursue legal judgments through the High Court ruling and in the test case that was brought by Mr Milne.³ Given the need for HM Treasury to ensure it is not setting undue precedent in its consideration of pension claims, there is a rationale for the government to test its liability through the courts (paragraph 3.8).

Assessing the appropriateness of the commutation factors

9 In 2009, the High Court was asked to judge whether the Home Office was able to delay the implementation of the revised factors, produced by GAD in 2006, to the Police Pension Scheme until October 2007. The High Court ruled that the Home Office did not have the discretion to delay implementation. In effect this meant that the factors were purely a matter for GAD's professional judgment. According to the GAD witness statement for the 2009 High Court judgement, up until 23 October 2007, when the Office for National Statistics published new mortality data, GAD deemed the factors to be actuarially acceptable (paragraphs 2.13 and 3.5).

10 The High Court judgment also ruled that GAD had a statutory responsibility to ensure the factors were kept up to date. The High Court ruled that the factors should have been updated and that GAD had a statutory responsibility to prepare the tables and update them regularly. This established the principle upon which the Ombudsman subsequently concluded that GAD should have updated the tables on behalf of the pension schemes in the 2001 to 2006 period (paragraphs 2.13 and 3.4).

³ On efficiency grounds the Pensions Ombudsman ruled on a test case brought by 'Mr Milne' which was considered to be representative of the impact on all the other pensioners that commuted their pension benefits between 2001 and 2006.

Challenging the jurisdiction of the Ombudsman

11 The Ombudsman invited challenges to its jurisdiction in March 2010.

GAD challenged whether it was an administrator as defined by the relevant regulations before 2005 and, therefore, whether the Ombudsman was able to conclude on its actions in this period.⁴ The Ombudsman concluded that he did have jurisdiction over this case in July 2011 (paragraphs 2.21 and 2.22).

12 Following the Ombudsman's conclusion, and supported by legal advice, GAD escalated its challenge to the Ombudsman's ability to rule on the case through the High Court and the Court of Appeal from September 2011 through July 2013. This legal process restricted the Ombudsman's ability to progress his judgment on the test case. The High Court and the Court of Appeal agreed with the Ombudsman's conclusion with regard to jurisdiction. This process took 20 months to complete (paragraphs 2.22 to 2.24).

13 GAD's legal challenge to the Ombudsman's jurisdiction was not directly related to the initial failure to update the commutation factors. This is because this legal process did not seek judgment on whether an initial mistake had been made. The case focused on the Ombudsman's ability to exercise judgement on GAD's actions in relation to the commutation factors in the pre-2006 period. It is not clear whether the government would have been able to avoid the liability, if the legal challenge to the Ombudsman's jurisdiction was successful (paragraph 3.9).

The Ombudsman's ruling

14 The Ombudsman upheld the test case brought by Mr Milne in May 2015. The Ombudsman concluded that there was maladministration as GAD should have proactively updated the commutation factors rather than waiting to be commissioned. The Ombudsman ruled that GAD had a professional duty to take the lead in the consideration of the assumptions that fed into the commutation factors as it had the expertise to do so. This resulted in the recognition of the £711 million liability by government in May 2015 (paragraphs 2.29 to 2.31).

The governance of pension schemes and GAD

15 During the period when this issue arose, there was a lack of independent oversight of the schemes by parties outside government or representation from scheme members. The fire authorities and police services were responsible for the governance of the schemes up to April 2015. Pensions can be complex and individual scheme members need support and appropriate representation to ensure that they understand their arrangements and can make the right decisions regarding their retirement. The commutation factors used by actuaries to calculate lump sums in accordance with scheme rules are one such complexity and have a significant impact on the pension benefits received by members (paragraphs 1.12 and 4.2).

⁴ GAD challenged whether the Personal and Occupational Pension Schemes (Pensions Ombudsman) Regulations 1996, applied to it during this period.

16 Scheme members (police officers or firefighters in this case) rely on the scheme and its advisers to determine whether the commutation factors that apply to their circumstances are appropriate. Governance arrangements need to be in place, therefore, to protect these individuals and ensure that they are not disadvantaged as a result of the administration of schemes (paragraphs 1.13 and 4.2).

17 The revised governance arrangements for unfunded public sector pensions following the 2011 Independent Public Sector Pension Commission's review are designed to provide protection for pensioners in the event of future issues of this nature. These include pension boards which are independent of scheme administration and have representation from scheme members in line with private sector practice (paragraph 1.14).

18 The mechanism by which GAD was commissioned and received funding contributed to the initial failure to update the factors. At the time of the initial failure to review the factors, GAD, the Home Office and DCLG understood that GAD needed to be commissioned to carry out a review of commutation factors. The funding structure of GAD, which required it to be commissioned by its clients before it could conduct work and charge for its services, contributed to the uncertainty regarding the requirements to review the factors. This position has been subsequently revised so that GAD can engage with departments proactively without concerns about its funding position (paragraph 4.3).

19 GAD has reviewed its internal controls to ensure its statutory duties, such as the review of commutation factors, are clearly understood and discharged. GAD's revised controls, together with the updated approach to governance of government pension schemes, are designed to provide a more rigorous approach to ensuring that scheme regulations are considered sufficiently in future cases of this nature (paragraph 4.4).