

Pensions Action Group Objectives

Estimated Costs

Summary

The estimated gross cost of implementing the various changes which the Pensions Action Group seeks in the Financial Assistance Scheme are indicated in the table below. These have been individually calculated, so the cost of the whole package would be slightly larger due to interactions between the different areas.

Because of offsets (income tax, VAT and benefit reductions) the net cost to Government will be approximately 70% of these figures.

	Annual Cost	Back Payments	Total Cost	% Increase
Post-retirement indexation	5.6 - 6.8	13.7	800	27%
Increase to 100%	4.7	17.4	768	26%
Pre-2004 payments	Nil	1.0	1.0	0.04%
Removal of cap	0.14	0.5	12	0.4%
Tax-free lump sum	0.4	0.8	32	1%
Unrestricted early access	Negative	Nil	Negative	N/A
Pre-retirement revaluation	Small	Small	Small	Small
Split Retirement ages	Negative	Nil	Negative	N/A
Earlier entitlement date	0.3	1.6	9.6	0.3%

(Costs are in £ million)

The total annual cost for the above (ignoring interactions) comes to less than £12 million in gross terms; around £8m after allowing for offsets.

To put this in perspective, this annual cost is equivalent to about 15% of the rounding error on the amount the DWP loses each year through its own mistakes in administering the benefits system.

If all of these changes are implemented, the total cost of the scheme would still amount to only 2/3 of the deficit in the pension schemes of the four failed banks which the Government is underwriting, whose members will receive their full pensions.

Introduction

The Pension Action Group is fighting for full restoration of the pensions which its members lost when their company schemes were wound up. Those whose schemes commenced wind-up between 1997 and 2005 are covered by the Financial Assistance Scheme which has been claimed to provide 90% of the expected pension but will in fact fall well short of that, with some members expecting less than 50%.

In her report on the treatment of this group, the Parliamentary Ombudsman recommended that the Government consider:

- Full restoration of all benefits which would have been provided by the original schemes (explicitly not just the pension payments);
- Consolatory payments by Government to those affected as recompense for the “outrage, distress, inconvenience and uncertainty” caused by the maladministration which she found;

We are unaware of any figures which have been published by Government for the overall cost of providing either of these measures in full. This document lays out our estimates relating to the individual components of the first measure based on what information we can find in the public domain. We leave it to others to calculate an appropriate cost for the second measure.

The estimates which follow are, at best, approximations because, in the absence of any detailed information, a range of assumptions and simplifications have been made. However, they should be sufficiently accurate to indicate the ballpark costs involved.

Post-retirement indexation

Under FAS rules, indexation of payments after the Normal Retirement Age is linked to the Retail Price Index, to a maximum of 2.5% pa, in respect of pension contributions made after April 1997 only.¹ This is the legal minimum that schemes were required to provide and therefore most members will be adversely affected because the scheme level of indexation is ignored when their Expected Pension is calculated.

It has been estimated by the DWP that, to increase the indexation cap to 5% in respect of all members and for all contribution years, would cost an additional overall total of £1 billion at net present value.² This figure includes indexation for many members at a greater rate than their schemes would have provided – something that PAG would not argue for. Allowing for this, we suggest that the overall cost might be nearer **£800m**, which would, of course, be spread over 50 or more years.

¹ <http://www.pensionprotectionfund.org.uk/FAQs/Pages/details.aspx?itemid=163&search=t&subjectid=8> Accessed 8 June 2010.

² “The current estimated cost of FAS is just over £3bn Net Present Value, including indexation at RPI capped at 2.5% on post 97 service. We estimate that the additional costs of applying indexation at RPI capped at 5% on all service to be around £1bn.” Email from Mike LeBrun at DWP, 22 July 2009.

We would like to know whether the DWP estimate assumed that inflation would in future be at 5% or greater in every single year stretching into the future. If that is the case, it would represent the worst-case outcome. We have looked at the RPI figures since 1947³, during which time the average annual inflation was 6.5% (347% over 53 years). There were 44 years when RPI was at 5% or less. If the actual inflation (capped at 5%) is calculated, it comes to an average of 3.85%. (This compares to the Green Book guidance from the Treasury for calculating NPV from future costs of 3.5% over the next 30 years.⁴) If we assume that the pattern over the next 50 years is similar to that of the last 50 years, then the cost of the indexation would be brought down further:

$$£800m \times (3.85\% / 5\%) = £616 \text{ million}$$

Because the effect of inflation is cumulative, the additional cost in the first few years would be small. The average accrued pension for non-pensioner members is estimated at £3,300 per year⁵ and there are currently 14,266 people receiving FAS payments.⁶ Since FAS payments are based on the notional pension which could have been bought by a member with his transfer value or final annuity payment, and this is specified at present on the same terms as the FAS payments themselves (i.e. with RPI indexation with respect to post-1997 contributions only, capped at 2.5%) the cost of any additional indexation has to be calculated on the basis of the whole accrued pension, not just the FAS component.

If we take the worst-case scenario and assume that inflation will run at 5% or above for the next few years, that would give a gross cost for the first year of:

$$14,266 \times £3,300 \times 5\% = £2.35 \text{ million}$$

Against that should be set the cost of the current indexation. The total cost of this is estimated by the DWP to be £240 million⁷. The proportion of the overall indexation cost which is already covered by the FAS can therefore be calculated as:

$$\frac{240}{240 + 800} = 23.08\%$$

and therefore the approximate additional cost of indexation on all contributions capped at 5% would, in the first year, be:

$$£2.35m \times (100 - 23.08) / 100 = £1.80 \text{ million}$$

³ RP02 Retail Prices Index (RPI) all items. Office for National Statistics.

⁴ Financial Assistance Scheme: Review of cost estimates, December 2007 page 17

⁵ House of Commons Public Administration Select Committee. "Pensions Bill: Government Undertakings relating to the Financial Assistance Scheme." Fifth Report of Session 2006–07, page 13.

⁶ http://www.pensionprotectionfund.org.uk/FAS/FAS_stats/Pages/FAS_stats.aspx. Accessed: 8 June 2010.

⁷ "I can confirm that the estimated cost of providing indexation at RPI capped at 2.5 per cent on post 1997 service is approximately £240 million or 0.2 billion." Email from Julie Lapraik to Terry Monk dated 15 September 2009

(The Net Present Value (NPV) cost of indexation will, of course, be zero; the figure above is measuring the cost of indexation relative to the cost of the present scheme, which will decline in real terms per recipient.)

In the following years, the cost will rise as new members start receiving payments from the FAS. The average payment per new member will decrease as members who reach Normal Retirement Age (NRA) later will have (on average) accrued fewer years of service and have been in more junior positions than those who reached it earlier. However this effect has been ignored in the following calculation, which are therefore likely to be an over-estimate.

In June 2010 there were 14,266 claimants. The FAS was established in May 2004 and covers schemes which commenced wind up prior to that date. The number of members reaching NRA each year prior to 2004 would be similar to the rate post-2004, but a proportion would have reached it before their schemes failed and so would have received protected pensions. Since the failure rate of schemes during the period 1997 – 2004 was greater towards the end, the recruitment to the FAS over 7 years was perhaps equivalent to three years at the post-2004 rate. Therefore, 14,266 claimants after 9 full years of recruitment suggests an annual rate of increase for the period to date of:

$$14,266 / 9 = 1,585 \text{ new recipients per year.}$$

Over the next 5 years, the additional cost of indexation may be estimated as in the following table.

Year	1	2	3	4	5
Average pension (£)	3,300	3,465	3,638	3,820	4,011
Indexation at 5% (£)	165	173	182	191	201
Extra cost per year (£)	127	133	140	147	154
Recipients	14,266	15,851	17,436	19,021	20,606
Total cost/year (£m)	1.81	2.11	2.44	2.79	3.18

Table 1 – *Additional cost in NPV of providing indexation capped at 5% in respect of all member contributions relative to current FAS scheme, assuming the worst case for future inflation (historical analysis suggests that 3.8% would be more appropriate).*

It should be pointed out that the above calculation of the annual cost is a worst case - the historical rate of RPI is rather lower than 5%. Over the last 5 years it has averaged 2.8% which, if continued forward would reduce the annual cost substantially. Furthermore, it assumes indexation on 100% of expected pension, rather than the 90% currently used by the FAS, and it assumes that no payments are capped.

It is the PAG view that members should receive the indexation promised by their scheme. A few schemes may have had unlimited indexation; we believe that this

should be recognised by the FAS as these members could otherwise have received a higher pension entitlement for the same investment, which would have been included in their ‘Expected Pension’ and hence increased their FAS payments. The long-term cost of including this benefit would be difficult to calculate, because it depends on inflation rates over the next 50+ years, but it is likely to be relatively small as such schemes were uncommon. Provided that inflation remains at or below 5% for the next 5 years, it would have no effect on the costs outlined above.

There would be, in addition, the cost of back-dating the indexation to each members’ NRA. This would have two components: the increased cost of current payments, and the cost of back-payments in respect of previous increases.

If we were to assume that the proportion of recipients reaching NRA is constant each year then the average date of commencement would be half way from the date eligibility started (i.e. 1997). This would make the mean payment starting date:

$$1997 + (2010 - 1997) / 2 = 2003$$

However, those who retired before 2004 are not currently eligible for payments or indexation before that date. We estimate (see next section) that there are 3,329 people in this situation. For these people, the starting date is 2004.

For the balance (who retired during or after 2004) the mean starting date will be:

$$2004 + (2010 - 2004) / 2 = 2007$$

The cumulative change in RPI since 2004 has been 18.8% and since 2007 it has been 7.5%.⁸

Thus the increased cost of current payments can be calculated as:

$$\frac{£36m \times 18.8\% \times 3,329}{14,266} + \frac{£36m \times 7.5\% \times 10,937}{14,266} = £1.58m + £2.07m = £3.65m$$

This annual cost should therefore be added to those given in Table 1.

The cost will remain constant, at NPV, for future years. The median life expectancy for men aged 65 in 2000 was 15.7 years and women 18.9 years, giving an average of 17.3 years.⁹ The pre-2004 recipients will have, on average, reached NRA in 2000, giving them an average of 7.3 further years of payments; the post-2004 group will have reached NRA on average in 2007 (when the equivalent ages were 17.4 and 20.1 years, averaging 18.75), giving a further 15.75 years of payments. The total forward cost of this increased level of payment may therefore be calculated as:

$$(£1.58 \times 7.3) + (2.07 \times 15.75) = £44m$$

⁸ RP02 Retail Prices Index (RPI) all items. Office for National Statistics.

⁹ Period expectation of life, 1981-2058, Principal projection. The Office for National Statistics, accessed at http://www.statistics.gov.uk/downloads/theme_population/NPP2008/wUKperiod08.xls on 24th June 2010.

Back payments may be calculated approximately as follows. For the pre-2004 group, whose payments started in 2004, for a starting payment of £100 they would have received annual increases as shown in the table below, giving a total increase equivalent to 0.69 times total pension. A similar calculation yields an increase of 0.17 of pension for the post-2004 group.

Year	Pre-2004 group		Post-2004 group	
	RPI	Increase	RPI	Increase
2003	100.0	0.0		
2004	103.5	3.5		
2005	105.8	5.8		
2006	110.5	10.5	100.0	
2007	114.9	14.9	104.0	4.0
2008	116.0	16.0	105.0	5.0
2009	118.8	18.8	107.5	7.5
Total		69.5		16.6

Table 2 - Calculation of back payments in respect of indexation for payments prior to 2010.

Using an average pension size of £3,300 per year, this gives a total cost for back payments of:

$$(\text{£}3,300 \times 3329 \times 0.69) + (\text{£}3,300 \times 10,937 \times 0.17) = \text{£}13.7\text{m}$$

A number of schemes not only had a cap on the maximum level of indexation but also had a floor, often of 2% or 3%, by which the payments would be increased even if the RPI fell below that level. The cost of providing this would depend completely on the future rate of inflation and so we have not attempted to estimate it. It should however be allowed for in any final settlement.

Increase to 100%

The FAS currently provides support up to 90% of expected pension. Increasing this to 100% would affect every recipient and so the total cost can be estimated from the total number of eventual recipients (124,250)¹⁰ and the average size of pension (£3,300 per year) and the current number of years of expected life post NRA (18.75) thus:

$$124,250 \times \text{£}3,300 \times 18.75 \text{ years} \times 10\% = \text{£}768 \text{ million}$$

The current annual cost can be calculated from the current number of payees (14,266) thus:

¹⁰ Financial Assistance Scheme Annual Report: 1st April 2007 to 31st March 2008. Page 4

$$14,266 \times 3,300 \times 10\% = \mathbf{4.7m}$$

The back payments can be calculated separately for the pre-2004 and post-2004 retirees.

The pre-2004 group all effectively started receiving payments in 2004 as no back payments are currently being made before that date. We estimate that there are 3,329 people in this group so their back payments may be calculated as

$$3,329 \times \text{£}3,300 \times 6 \text{ years} \times 10\% = \text{£}6.6\text{m}$$

If we assume that the post-2004 group reached NRA on average in 2007, that would give an average payment period of 3 years and a cost of

$$(14,266 - 3,329) \times \text{£}3,300 \times 3 \text{ years} \times 10\% = \text{£}10.8\text{m}$$

giving a total cost of back-payments of

$$6.6 + 10.8 = \mathbf{\text{£}17.4\text{m}}$$

Pre-2004 payments

There is a small number of people who reached NRA between April 1997 and May 2004 after their schemes commenced wind-up but before the FAS was established. The FAS as it is presently constituted only makes back-payments from the start of the scheme (May 2004), not from when the injustice began (April 1997).

The DWP's own estimate for the cost of this change, released as a result of a Freedom of Information request, is £1 million over the lifetime of the scheme, in Net Present Value terms as at 2010.¹¹

The Cap

The DWP stated in 2010 that "*Only around two per cent of people over State Pension age who currently receive an occupational pension receive more than this [the level of the cap] from any one pension scheme.*"¹²

The DWP have also said that "... *very few people have, as yet, had the cap applied to their entitlement ...*"¹³

In the PPF as at May 2009 there were 33 members who were capped¹⁴ out of a total of 30,463 recipients,¹⁵ a level of 0.11%. It is likely that this figure will be reflected in the FAS statistics, as the intake of the two schemes is similar.

¹¹ Letter from Minister of State for Pensions dated 13 February 2014.

¹² Government Response to Consultation on Draft Regulations. The Draft Financial Assistance Scheme (Miscellaneous Amendments) Regulations 2010. January 2010, Section 302

¹³ Government Response To Consultation On Draft Regulations. The Draft Financial Assistance Scheme (Miscellaneous Provisions) Regulations 2009, page 20.

The majority of those affected will lose relatively small amounts (although they will be important to those who are affected). This is because of the distribution of incomes (relatively few people have very high incomes) and because many high-paid individuals such as company directors had separate schemes which would perhaps not be affected by the insolvency of their company. On this basis, the average loss per member resulting from the cap might be estimated at around £10k per year.

There are currently 14,266 claimants, so the cost of abolishing the cap this year could be estimated as:

$$14,266 \times 0.1\% \times \text{£}10\text{k} = \text{£}143\text{k}$$

Back payments can be calculated in two parts. The pre- 2004 group would be eligible from 2004, giving a total cost of

$$6 \text{ years} \times 3,329 \times 0.1\% \times \text{£}10\text{k} = \text{£}200\text{k}$$

The post-2004 group started receiving payments, on average, in 2007, giving

$$3 \text{ years} \times 10,937 \times 0.1\% \times \text{£}10\text{k} = \text{£}328\text{k}$$

Giving a total for back payments of **£528k**

The total cost of the FAS payments this year is £36 million so it would represent:

$$\frac{0.143}{36} = 0.4\% \text{ of the total cost.}$$

The total cost of the FAS scheme is estimated at £3 billion NPV so the total cost of removing the cap might be:

$$\text{£}3,000 \text{ million} \times 0.4\% = \text{£}12 \text{ million.}$$

In the 2007 announcement of the extension to the FAS it was stated “*This will be subject to a cap of £26,000, the value of which will be protected.*”¹⁴ In fact, in the scheme as it is presently constituted, the cap is only protected up to the date of the first payment (i.e. to NRA). Thereafter payments only increase with the standard indexation (maximum 2.5% in respect of post-1997 contributions only). The protection is therefore withdrawn just at the time it is most needed.

As can be seen from the analysis above, the cost of removing the cap entirely is very small in relative terms; the cost of protecting its value against inflation for the life of

¹⁴ Approved Judgement Case No HC08C02331, High Court of Justice Chancery Division, Paragraph 135(4)

¹⁵ Halon Pension Scheme the Latest to Transfer to the PPF. PPF Newsletter dated 11 June 2009 accessed at <http://www.pensionprotectionfund.org.uk/News/Pages/details.aspx?itemID=120&archive=1> on 16 June 2010.

¹⁶ Hansard written statement. HC Deb, 17 December 2007, c100WS

the recipients is tiny. Without this full indexation, those affected are punished twice, once by being capped and a second time with the loss of indexation.

Tax-free lump sum (TFLS)

Many people hit by shortfalls in their endowment mortgage had planned for all or some of their outstanding mortgage or other debts to be paid off by the 25% tax free cash from their pension scheme. However the ability to take cash is very restricted under FAS.

Those recipients whose schemes wound up before the assets could be transferred to the FAS could transfer their funds into a Section 32 or Personal Pension Plan which preserved the entitlement to a TFLS of 25% of their original expected pension. Therefore, the only members of this group affected by the restriction in the FAS rules are those whose residual pension was less than 25% of their expected pension (i.e. those whose schemes were worst affected). In these cases, the proportion of the FAS payments to be converted to cash would be that needed to bring the TFLS up to 25%.

Those members whose residual scheme assets were taken over by the FAS have their TFLS limited to 25% of the value of their residual pension. If we assume that there is an even spread of funding levels among members then that would suggest that the average TFLS available is about 12.5% (i.e. half) and all members would be affected as no Section 32 transfer was offered. It is estimated by the DWP that the number of recipients in this category is 61,000¹⁷, out of a total of 130,000 members eligible for FAS payments.¹⁸

The cost to the government of reinstating the TFLS for both groups would be zero, as the residual FAS payments would be actuarially reduced to an appropriate level.

There would be a loss to the Treasury in respect of income tax foregone for both groups. In its 2007 review of scheme assets, the DWP stated that, of the 115 schemes which reported funding levels on a full buy-out basis, 6 were funded below the 25% level¹⁹. If this is representative of the numbers of members for the group without scheme assets passing to the government, this would be equivalent to

$$6 / 115 = 5.2\% \text{ of members in this group}$$

The group represents 69,000 people, so the overall proportion affected is

$$5.2\% \times (69,000 / 130,000) = 2.76\%$$

The proportion in the second group is simply

$$61,000 / 130,000 = 46.9\%$$

¹⁷ Financial Assistance Scheme Review of Scheme Assets, Interim Report, DWP, July 2007. Page 13

¹⁸ Financial Assistance Scheme Review of Scheme Assets, Interim Report, DWP, July 2007 Page 32

¹⁹ Financial Assistance Scheme Review of Scheme Assets, Interim Report, DWP, July 2007 Page 17

Giving a total of 49.7% of all recipients affected.

For these members, the average amount of TFLS to be made up would be expected to be around half, namely 12.5%, given an even distribution of scheme funding levels.

So the amount of FAS to be brought forward can be estimated as:

(Total cost of FAS)
x (Proportion of members affected)
x (Proportion of FAS payments brought forward)

Namely:

£3,000 million x 49.7% x 12.5 / (100 – 12.5%) = £213 million

Given that the average pension covered by the FAS is £3,300 per year relative to the personal allowance of £9,490 pa for the over-65s²⁰, the tax loss from this is likely to be reduced. If we assume that 75% of it would be eligible for tax at the basic rate of 20%, this would give a tax cost to the Treasury of:

£213m x 75% x 20% = **£32 million**

This would be spread over the full life of the FAS. As a proportion of the total cost of the scheme, it may be expressed as

£32m / £3,000m = 1.1%

Given that the annual expenditure by the FAS in the current year is approximately £36 million, the initial annual cost in lost tax may be calculated as:

36,000,000 x 1.1% = **£396,000**

If the ability to claim a TFLS were to be back-dated, only those who are already receiving payments would be eligible and they would be from schemes which did not transfer assets to the Government. There are 14,266 people currently claiming FAS payments so, if we assume an average total pension of £3,300 per year, that gives a total annual pension equivalent to

14,266 x £3,300 = £47m

The FAS uses a pension to lump sum conversion rate of approximately 16:1²¹ which gives a total value of these pensions of

£47m x 16 = £753m

As above, the amount of FAS payment to be brought forward may be estimated as

²⁰ Rates and allowances - Income Tax, HMRC. Accessed at <http://www.hmrc.gov.uk/rates/it.htm> on 15 June 2010

²¹ Consultation - Revision of the annuity factors employed by the Financial Assistance Scheme, DWP, March 2008 Page 25, example 1.

$\text{£}753 \text{ million} \times 5.2\% \times 12.5 / (100 - 12.5\%) = \text{£}5.6 \text{ million}$

The cost of tax foregone would therefore be

$\text{£}5.6\text{m} \times 75\% \times 20\% = \text{£}0.84 \text{ million}$

The main objection raised to providing a TFLS in respect of FAS payments has been the same as for providing unrestricted early access, namely that “... *making payments early, even at reduced amounts, brings costs forward unacceptably.*”²²

As has been shown, the size of the payment which would be brought forward (£213 million) is not large, especially in the context of the estimated £1.7 billion of scheme assets which the Treasury is currently absorbing and that it will be spread over 40 years as members reach their retirement age. However, if this really is a stumbling block, the finance industry might be invited to introduce a ‘reverse annuity’ whereby a recipient could make over a proportion of his FAS payments to an insurance company who in return would provide a lump sum net of tax. That portion of the FAS payments would then be made to the company until the death of the original recipient. This would involve the exchequer in no advance costs, no borrowing and no costs apart from the trivial administrative cost of the additional payee.

Early Access

Most schemes had a provision which allowed members to retire early on an actuarially reduced pension. This is not reflected in the FAS because it is considered that it would bring costs forward unacceptably. There is no suggestion that it would be other than cost-neutral.

In the FAS as it is currently constituted, it would actually save Government money to allow early access. This is because the revaluation of pension prior to NRA is rather more generous than that post-retirement. For this reason also, it is unlikely that it would be a popular option.

Early FAS payments would also bring forward payment of tax and other offsets. It is estimated below that this would amount to 31.4% of the total payment.

If these considerations are insufficient to overcome Treasury reluctance to contemplate bringing forward payments then, as in the previous section, private sector assistance could be sought. In this case an ‘annuity conversion’ would be required, whereby an insurance company would pay a reduced annuity to the recipient from the nominated date in return for receiving the payments direct from the FAS from the recipient’s NRA until he dies.

²² Government Response to Consultation on Draft Regulations: The Draft Financial Assistance Scheme (Miscellaneous Amendments) Regulations 2010, Section 305.

Pre-retirement revaluation

We believe that original scheme rates should apply to all revaluations prior to retirement. Peoples' pension expectations and retirement plans were based on benefit statements and pension projections provided by their trustees and the failure to meet those expectations is one of the reasons why 90% is not being achieved by the FAS.

We accept that where the scheme revalues excess benefits (i.e. over GMP) then the scheme basis and the FAS basis are broadly similar in periods of low inflation

There are, however, differences arising from the fixed rate revaluation basis that applies to different tranches of contracted-out service. These were the terms on which the scheme met the then current contracting out requirements of the DWP.

Increasing the revaluation to scheme terms would be a cost to the FAS as it would increase the headline pension on which 90% is calculated. We are not able to estimate this cost but do not believe it to be substantial for the following reasons

- Many schemes although underfunded were able to meet GMP liabilities under the priority orders
- A lot of the benefits are low both due to the nature of the GMP component and the fact that the average FAS benefits is around £2,500 (See Pre-2004 Payments section)
- Some of these benefits have already been bought out on scheme terms with Insurers

Split Retirement ages

There are some schemes where members have accrued benefits which would have been accessible at different ages, but the FAS benefits are paid from the overall scheme retirement age even if a member had the majority of benefits due for payment at an earlier age.

There would be no cost in allowing a member to access his benefits at an earlier age as they would be actuarially reduced (to the extent that the delayed payments under the current scheme are increased). There would be some bringing forward of payments but the number of members affected and therefore the amounts would be small and would be partially offset by earlier tax payments and benefit reductions. If this is considered to be a serious problem by the Treasury, then a private sector solution could be sought (see Early Access section above).

Earlier entitlement date

Some schemes had a provision which allowed for retirement (with or without consent) earlier than the "Normal Retirement Age" (as legally defined), without financial penalty. Where this was normally permitted, and where the scheme had made financial provision, we believe that this earlier age should be taken as the NRA for the

purposes of FAS payments, as it is in the PPF, because the money could otherwise have been used to increase the headline pension.

In the PPF: “Normal pension age is the normal retirement date under the scheme rules, or such earlier age specified in the rules where the only condition for the member to retire without actuarial reduction is the attainment of a particular age or length of service.”²³

We have not been able to find any hard information on how common this practice was, but informal information suggests that it would have been uncommon.

If we assume that 2% of members had this facility, and that it granted them on average an extra 3 years of pension (and hence FAS payments) then, with the total cost of the FAS being £3 billion, and each member expected to claim for 18.75 years, the total cost would be:

$$£3,000m \times 3/18.75 \times 2\% = \mathbf{£9.6m}$$

The cost would be front loaded, in that it involves earlier payments, with back payments due to those who are already in receipt of payments.

Those who reached NRA before 2004 do not currently receive back payments. Therefore, with an average FAS payment of £2,500, the 10,937 who are receiving payments and who reached NRA after 2004 would cost:

$$10,937 \times 2\% \times £2,500 \times 3 \text{ years} = \mathbf{£1.64m}$$

The extra cost per year thereafter will depend on the number of people reaching their retirement age but as a rough approximation it can be taken as the yearly average of the back payments, namely:

$$£1.64m / 6 = \mathbf{£270k}$$

Offsets

In its assessment of the cost of the FAS²⁴, the DWP stated:

17. As FAS assistance payments are made, expenditure on some Income Related Benefits, for example Pension Credit and Housing Benefit, may be reduced. Similarly, FAS payments are taxable, so there will be increases in tax revenue. These reductions in Income Related Benefit expenditure and increases in tax revenue are often referred to as offsets.

²³ Pension Protection Fund FAQ at <http://www.pensionprotectionfund.org.uk/FAQs/Pages/details.aspx?itemid=11&search=t> accessed on 16 June 2010.

²⁴ Financial Assistance Scheme: Review of cost estimates, December 2007 page 9

18. The level of these offsets depends critically on the overall income of FAS recipients, taking into account state pensions and other private pensions and investment income they may have built up. No direct information is available on this, so the estimated offset rates are based on assumptions and are uncertain.

19. Whilst the gross NPV cost of existing FAS is £1.99bn, taking these offsets into account would produce a net cost to government as a whole of £1.47bn NPV

Taking account of these offsets, the additional cost of providing the benefits considered here may therefore be reduced, giving a discounted cost relative to the gross cost of:

$$\frac{1.47}{1.99} = 73.9\%$$

In addition, a substantial proportion of the benefits received will be spent on products which attract VAT, which will be at at 20%. 55% of consumer spending attracts VAT at this rate,²⁵ with an additional amount collected on fuel, which is a significant element of expenditure for pensioners. Money recouped through VAT would represent a further reduction in the net cost of, say,

$$74\% \times (55\% \times 20\%) = 8.1\%$$

giving a discounted cost of:

$$\frac{100 - 8.1}{100} \times 73.9 = 67.9\%$$

Cost comparisons

The cost of providing the improvements considered above is small in relation to the amounts already being spent in similar areas by the Government, as the following examples illustrate.

Annual cost

The DWP lost £1.1 billion in 2008/09 due to its own errors in the payment of benefits. Expressed to one decimal place,²⁶ the rounding error on this figure is £50m.

The total initial annual cost of providing all of the improvements we are seeking comes to under £12 million in gross terms; around £8m after allowing for the offsets. That is to say about 15% of the rounding error on the amount the DWP throws away each year.

Total cost

²⁵ The IFS Green Budget. The Institute for Fiscal Studies, January 2009. Page 195

²⁶ Fraud and Error in the Benefit System: October 2008 to September 2009, DWP, 2010. Table 3.1 Available at: http://statistics.dwp.gov.uk/asd/asd2/fem/fem_oct08_sep09.pdf

The Government has underwritten the deficits in the pension schemes at the failed banks to a total of £6.9 billion: Northern Rock (£60m²⁷), Bradford & Bingley (£100m²⁸), RBS (£3bn²⁹) and Lloyds (£3.7bn³⁰). Unlike our pension plans, these schemes were largely non-contributory and are subject to none of the restrictions of the FAS or PPF. In particular, executives such as Larry Fish (who was largely responsible for the investments which brought down the RBS) will keep their pensions (his is £30,000 per week³¹ - 50 times the FAS cap), all supported by the taxpayer.

We estimate that the total cost of the FAS for the 130,000 victims, including all the improvements we are suggesting, would be £4.5 billion - just 2/3 of the cost of protecting these four gold-plated schemes, and the cost in our case will be spread over 50 years.

*Pensions Action Group
June 2010*

²⁷ <http://www.guardian.co.uk/business/2009/aug/05/pension-deficits-ftse-100> Accessed on 22 June 2010

²⁸ <http://www.independent.co.uk/news/business/news/pension-guarantees-for-bankers-savaged-1776538.html> Accessed on 22 June 2010

²⁹ http://www.thisismoney.co.uk/markets/article.html?in_article_id=500848&in_page_id=3 Accessed on 22 June 2010

³⁰ <http://www.dailymail.co.uk/money/article-1230328/Taxpayers-plug-black-hole-Lloyds-pension-scheme.html> Accessed on 22 June 2010

³¹ <http://www.dailymail.co.uk/news/article-1160693/Revealed-The-RBS-director-1-6million-pension-Thats-double-Fred-Shreds.html> Accessed on 22 June 2010