

Unfairness at the Heart of the Financial Assistance Scheme

Introduction

The Pensions Action Group (PAG) is campaigning for the full restoration of the entitlements which were lost by workers with final-salary pensions when their schemes were wound up. Those whose schemes commenced winding up between 1997 and 2005 are covered by the Financial Assistance Scheme (FAS).

The FAS does not cover 100% of the loss and PAG contends that it should, in line with the Ombudsman's findings in the document "Trusting in the Pensions promise" of July 2005.

However, given a scheme which provides partial compensation, PAG believes that it should be applied fairly to all members; that is to say, every member should receive an equal proportion of the money they saved in their pension scheme. The FAS does not provide this: some members can currently expect to receive close to 90% of their original benefits; some will get less than 50%, with the bulk of members falling in between.

To some extent, this distribution is intentional. When the FAS was first introduced, it was very limited in its coverage and so, sensibly, the money was targeted at those with the greatest need and to minimise costs. The scheme has been substantially extended since then, and all affected members are now covered, but that original approach has been perpetuated in the later regulations. PAG believes that this has resulted in a series of features which favour certain members over others in an arbitrary and unfair fashion. Although some members do have needs which are greater than others, but this issue is dealt with elsewhere in the system: those in greatest need are helped by the benefits system; those who are already well-off are taxed at their marginal rate and are paying more VAT and other taxes. The FAS therefore no longer needs to contain any redistributive elements. This principle has already been accepted in the treatment of savers in Northern Rock and in the rescue of the various bank pension schemes, and in the forthcoming Equitable Life settlement.

This paper will therefore seek to identify the major unfairnesses and suggest ways in which they might be remedied.

Post-retirement indexation

It is more expensive to provide a pension with index linking (i.e. some protection against inflation) than without. Therefore those members of schemes which provided greater indexation than the statutory minimum accepted, in return, a lower initial retirement income than they would otherwise have received - part of their pension savings were used to provide indexation.

However, the FAS, when calculating the ‘expected pension’ ignores the provision of indexation and bases its calculations only on the initial pension payment. Since the FAS payments have only limited indexation, equivalent to the statutory minimum, this means that this part of their pensions savings is ignored, and hence lost. Yet those with the minimum indexation do not suffer any such loss.

The lack of indexation in the FAS was designed to reduce costs, but it does so by unfairly penalising some members whilst others are unaffected.

Pre-2004 payments

Those who retired before 2004 received no FAS payments for those earlier years, in spite of having suffered the same injustices as all the other beneficiaries. This is so clearly unfair that it should need no further elaboration.

The Cap

Payments under the FAS are calculated on the basis that the total of the ‘actual pension’ and the FAS payments received by an individual cannot exceed a certain value, known as the cap. This value is increased by RPI each year (it is currently £29,386) and it is applied during the calculation of each member’s entitlement when they reach NRA. It is then fixed, with no further indexation apart from that applied to normal FAS payments. The original aims were, presumably, to save costs and to avoid giving tax-payers’ money to highly-paid executives.

This is unfair on two counts. Firstly, it of course means that different members receive different proportions of their savings as pension, but without discriminating between highly paid individuals (who might have accrued £29k p.a. of pension from even a single year’s contributions and escapes the cap) and those with long service (such as a shop floor worker who, over 40 years of service with a company, might accrue a pension worth £30k a year who would be capped). The Cap takes no account of length of service nor of the proportion of an individual’s total pension savings that his FAS pension might represent and is thus arbitrary and unfair in its effect.

Secondly, the cap is not revalued after NRA. This means that the members get an ever lower proportion of their expected pension for each year of their retirement.

As of 2009, there were only 15 people receiving FAS payments who were affected by the cap. Such small sums are involved that saving money can no longer be used as a sensible justification for allowing the cap to remain in place.

Ideally, the Cap should be removed. If that is not possible, it should be set at a level which would not penalise middle-income members, or it should be related to the number of years of service, being higher for longer service. At the very least, the revaluation of the cap should continue after retirement so that the cap retains its value for the life of the recipient.

Tax-free lump sum

The tax-free lump sum (TFLS) is an important part of most people’s retirement plans, and the tax saved is a significant benefit. The FAS only permits those whose schemes had significant residual assets to take a TFLS, and then only up to 25% of the value of

their share of the assets (not the value of their original pension). It is clearly arbitrary and unfair that members should only receive this benefit in proportion to the funding level of their original scheme. It means that those who have lost the most get the lowest benefit.

Furthermore, the tax concession is available to every single pension saver in the country, no matter how wealthy. How can it be fair that a worker who has lost all of his pension (through no fault of his own) is the only person who has to pay the full amount of tax on the FAS pension money that he does receive?

Pre-retirement revaluation

The FAS uses a standard calculation to revalue pension entitlements from the date of leaving a scheme. Where this differs from scheme rules, there will be some people who gain and others who lose. In order to eliminate this arbitrary variation, scheme rules should always be used.

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. If a member has certain benefits which were payable at a certain age then he should receive them then. It is unfair to make him wait, especially if the reason is for the administrative convenience of the FAS.

Earlier entitlement date

Some schemes made provision for members to retire before the NRA without any actuarial reduction. This was a significant benefit which was built into the original scheme and would have been funded by the member's contributions, yet it is ignored by the FAS. Those affected could otherwise have had a larger headline pension. It is unfair that they should lose that part of their retirement savings whereas those without this facility are unaffected.

Comparison is often made between the FAS and the Pension Protection Fund (which is the equivalent to the FAS for those whose schemes commenced wind-up after 2005) as a reason to limit FAS payments. In this case, the PPF rules state: "*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.*"

The FAS should adopt the same position.

Voluntary early retirement

Most schemes would allow people to take their pensions early with an actuarial reduction and this is a very important feature for some people, particularly as it is now so hard for older people to find work. The FAS does not allow for this because of the cash flow implications. Yet, as noted in our paper on costs, even this objection could be overcome by setting up an 'annuity swap', whereby the recipient could obtain a reduced annuity in return for making over his FAS payments to the annuity provider.

Possible solution

Some of the issues addressed above (such as pre-2004 payments) need to be addressed directly with specific payments. However others could be met through the existing structure. The problem then becomes how to organise this without the administrative nightmare of having to replicate every recipient's scheme entitlements individually and at acceptable cost.

The FAS already operates a system which could be readily adapted to allow for variations in benefits between members of different schemes.

When an individual is assessed at Normal Retirement Age (NRA), if he (or she) did not receive an annuity from his scheme, the FAS currently estimates what annuity could have been bought at the time with his share of the assets, and this becomes his 'actual pension' for the purpose of calculating FAS payments.

A similar process could be used to calculate the 'expected pension' for someone with greater levels of indexation or other benefits than those provided by the FAS:

1. Determine the cost of obtaining an annuity which provides the same level of benefits that the member expected.
2. Determine what level of pension could be obtained with FAS levels of indexation for the same money. This would then become the 'expected pension'.

In this way, all aspects of a member's entitlement could be taken into account. This would require some extra administrative work, but most of it could be done at the scheme level, and it would only have to be done once for each recipient.

Resources (both administrative and financial) to effect this change could be freed up by making a simple change to the existing system. At present there is no *de minimus* cut off for recipients. The FAS staff must therefore devote considerable resources in tracking down people who will receive comparatively small amounts of money. We would not argue that these people should lose their entitlement (quite the reverse), but it does not seem unreasonable that those who stand to receive less than, say, £500 per year from the FAS should be expected to apply for it, rather than being sought out. Given that the average entitlement from the FAS is around £2,500 per year, this could dramatically reduce the administrative burden and, because many of those who are not in need will not apply, also reduce the direct costs - money which could be redirected to those who are more seriously affected.

Members have seen examples where administrators have spent many thousands of pounds pursuing long lost members with a very small entitlement, which was both expensive in fees and delayed completion of the wind-up.