

## Ombudsman's Determination

Applicant	Mr N
Scheme	Central Networks Group of the Electricity Supply Pension Scheme ( <b>the Scheme</b> )
Respondents	Western Power Distribution Limited ( <b>WPD</b> ) The Group Trustees of the Scheme ( <b>the Trustees</b> )

## Outcome

1. I do not uphold Mr N's complaint and no further action is required by WPD or the Trustees.
2. My reasons for reaching this decision are explained in more detail below.

## Complaint summary

3. Mr N's complaint is that:
  - his Guaranteed Minimum Pension (**GMP**) has been included within his Scheme pension, rather than paid to him in addition to it;
  - it has been funded from his total Scheme contributions (Employer and Employee), rather than as a liability on the Employer to make additional and separate contributions to overall Scheme funds or, from other funding, and
  - he was not made aware that it was already included in his individual Scheme funds until reaching State Pensions Age (**SPA**).

## Background information, including submissions from the parties

4. Extracts from the following documents are provided in the Appendix:-
  - The Midlands Electricity Pension Scheme (**MEPS**) Members' booklet.
  - The Electricity Supply Pension Scheme (**ESPS**) Member's booklet.
  - The consolidated version of the Rules of the ESPS for the Midlands category of the Central Networks Group, August 2013 (**the Scheme Rules**).
  - Pensions Scheme Act 1993 (**PSA 1993**).

- Occupational Pension Schemes (Contracting-out) Regulations 1996 (**the 1996 Regulations**).

5. The Scheme is a contributory arrangement funded by Employer and Employee contributions.
6. The defined benefit (**DB**) section of the Scheme provides on a member's retirement at or after Normal Pension Age:
  - i. an annual pension of 1/80th of the Member's pensionable salary for each year of contributing service with a maximum of 45/80ths; and
  - ii. a lump sum of 3/80ths of the Member's pensionable salary for each year of contributing service with a maximum of 135/80ths.
7. The Scheme contracted-out of the State Earnings Related Pension Scheme (**SERPS**) in the late 1970's.
8. Mr N joined the Scheme in January 1973 (at age 20) and left the Scheme in January 2011 and took early retirement on 26 November 2011.
9. Mr N reached his SPA on 16 January 2018. Immediately prior to his SPA his total gross monthly Scheme pension (including AVCs) was 100%\*. At SPA the split of his Scheme pension was adjusted to reflect the commencement of his GMP as,

Pre'88 GMP	= 7.5%
Post'88 GMP	= 5.75%
Excess pension	= 85.65%
AVCs	= £1.1%
Total	= £100%

*\*Mr N requested that his personal financial information was not published and therefore the details are shown in percentage terms above, but still provide the proportion of the GMP element included in his monthly Scheme pension at SPA.*

10. Mr N says the Employer failed to explain the concept of contracting-out of SERPS. He says he did not have a choice to become a member of the MEPS and subsequently the ESPS except by being sold the concept that employees would be financially no worse off in their benefits when reaching SPA, the financial provision being based on the same premise as if they had been allowed to contract-in.
11. Mr N says:

"The incorrect application of principles and administration processes and procedures applied by the Employer to meet their obligations under the Act(s) for Guaranteed Minimum Pension (GMP)/Contracted Out Pension Equivalent (COPE) provision from the Employee's Final Salary Pension (FSP) on reaching SPA, that in my opinion,

should be provided as an additional pension benefit and funded separately by the Employer through the ESPS or, other funding.”

## Adjudicator’s Opinion

12. Mr N’s complaint was considered by one of our Adjudicators who concluded that no further action was required by WPD or the Trustees. The Adjudicator’s findings are summarised briefly below:-

- Until 1988, employees could only contract-out if they were members of a DB occupational pension scheme. The arrangement was that the employer and the employee were allowed to pay a reduced rate of National Insurance (**NI**) contributions and in return for this, the pension scheme had to promise to at least match the SERPS pension the employee would have built up if they had remained contracted-in. This ‘promise’ is known as the GMP.
- As its name indicates the GMP is a guaranteed minimum pension. It is not a separate additional pension to a member’s scheme pension. If the member’s GMP exceeds their scheme pension at SPA then the scheme is required to provide the difference.
- Rule 13 of the Scheme Rules says, if a member has a GMP in relation to the pension for him under the Scheme (my emphasis) the weekly rate of the pension (my emphasis) from age 65 for a man (and age 60 for a woman) shall not be less than the GMP. This complies with Section 13 of the PSA 1993.
- Rule 14 specifies the pension payable to a member at or after Normal Pension Age as an annual pension of 1/80th of the member’s pensionable salary for each year of contributing service (with a maximum of 45/80ths).
- When Mr N reached SPA his pension (under Rule 14) exceeded his GMP. Consequently Rule 13 was satisfied.
- On reaching SPA Mr N’s pension was adjusted to reflect the commencement of his GMP, as the Scheme is required to escalate the post’88 GMP element of his pension (in accordance with orders made under section 109 of the PSA 1993).
- Mr N says the Employer at the time the Scheme elected to contracted-out failed to explain the concept of contracting-out. However, given the significant time that has elapsed since the election to contract-out was made and the fact that the Employer has changed several times it is likely to be difficult to obtain evidence either way. A colleague of Mr N’s says no such evidence exists.
- But even were the Ombudsman to decide, on balance, that the Employer had not properly informed members, it is unlikely that he would find that, as a result, Mr N has been caused an injustice. Again, because of the elapsed time since then it is not possible to say what Mr N would have done differently (if anything) at that time

and that as a consequence he has been caused a financial loss by remaining a contracted-out member of the Scheme.

- The MEPS booklet says for contracted-out members, instead of receiving an additional State Pension, a GMP broadly equivalent to the additional State Pension is paid from the Scheme and that the Scheme guarantees that pensions paid on or after Normal Retirement (Pension) Age will not be less than the GMP. In respect of NI it says members pay reduced NI and the saving takes account of the pension which the MEPS will provide in place of the additional State Pension.
  - The ESPS booklet uses similar wording, explaining that members contracted-out of SERPS pay a lower rate of NI and that the Scheme has to guarantee that the amount of pension paid is not less than the GMP.
  - Both booklets sufficiently explain contracting-out.
  - Although Mr N says he did not have a choice in the matter, he could have sought independent financial advice at the time on whether to remain in the Scheme as a contracted-out member, or leave the Scheme and maybe transfer his benefits to another pension arrangement of his choice. Then again, if he had decided to leave the Scheme and contribute to a private pension arrangement it would have cost him significantly more to at least match the benefits provided by the Scheme and the contributions paid by the Employer.
  - Mr N says he has funded the provision of his GMP rather than the Employer. But the Scheme is a contributory arrangement, funded by Employer and Employee contributions. Pension benefits are paid from the Scheme's pooled Fund.
13. Mr N did not accept the Adjudicator's Opinion and the complaint was passed to me to consider. Mr N has provided his further comments which do not change the outcome. I agree with the Adjudicator's Opinion and I will therefore only respond to the key points made by Mr N for completeness.

## **Ombudsman's decision**

14. Mr N says:-

- He considers that his Scheme pension is sacrosanct and purely based on his final salary at retirement.
- Not until he reached SPA was there any reference that the Employer's obligation for GMP was included within his pension.
- His pension was not adjusted at SPA to reflect the commencement of his GMP, it was already included in his pension amount from the date he took early retirement. This is a transparency issue regarding the administration processes and procedures in that his GMP was not shown separately until he requested this

and received WPD's letter of 30 January 2018, which detailed his pension increase from 31 March 2018.

- The arrangement with contracting-out was that the Employer and Employees were allowed to pay no additional NI contributions over and above that which was required to fund the Basic State Pension and in return for this, the Employer had to promised under its obligations to at least match the SERPS/S2P pension the Employee would have built up if they had remained contracted-in.
- The Adjudicator's statement that the Employer and Employee were allowed to pay a reduced rate of NI contributions is a popular misconception of the actual facts as there was no requirement for either to subscribe to SERPS/S2P as they were contracted-out.
- The Adjudicator's comment that he could have sought independent financial advice at the time he was contracted-out is hypothetical and to a certain extent patronising. When he joined the MEPS/ESPS at age 20, he trusted the Employer, the Scheme Trustees and Trade Union Representatives, to undertake their legal responsibility to act in the best interests of himself and the other Scheme Members and beneficiaries. There was no requirement, for him as a Member, to seek independent financial advice.
- The 1996 Regulations provide a level of security to individual Members and the right to object to the proposals without necessarily leaving the Scheme. There would have been a choice in the matter had the full facts been disclosed by the Employer, the Scheme Trustees, and Trade Union Representatives, at that time.
- There is an inference in the Adjudicator's Opinion that he was aware of the impending losses to his Scheme/State Additional Pension and had accepted the overall losses. This is not based on any factual information.
- WPD and the Trustees should be directed to provide additional transparency for ESPS Members regarding the effect of the GMP/COPE element on their ESPS and State Pensions before and after reaching SPA.

15. Firstly, I do not consider that Mr N has incurred any injustice in this matter.
16. The GMP is payable from SPA. It is not a separate additional pension. If a member's GMP exceeds their Scheme pension at SPA then the Scheme is required to provide the difference. This is reflected in Rule 13 of the Scheme Rules.
17. When Mr N reached age 65 his pension exceeded his GMP. Consequently Rule 13 was satisfied.
18. I agree with the Adjudicator that the MEPS and ESPS booklets reasonably explain contracting-out.
19. Mr N says he would have had a choice in the matter if he had been provided with the "full facts" around the time of the Notice of Intention and Election to contract-out.

20. But he could not have remained an active contracted-in member of the Scheme. In which case, if he had decided to leave the Scheme and had contributed to a private pension arrangement, it would have cost him considerably more to at least match the benefit provisions of the Scheme in a private arrangement with the added risk of investment returns and no Employer contributions. In addition, he would have had to pay full rate NI contributions.
21. Mr N says he has incurred “overall losses” as a consequence of being contracted-out. But this is to ignore the benefit he has received of paying reduced NI over that period.
22. Mr N says his GMP should be solely funded by the Employer. I do not agree. The Scheme is a contributory arrangement, funded by employer and employee contributions. Pension benefits are paid from the Scheme’s pooled Fund.
23. Mr N requests that I direct WPD and the Trustees to provide additional transparency for ESPS Members regarding the effect of the GMP/COPE element on their ESPS and State Pensions before and after reaching SPA. That is a matter which Mr N may take up with WPD and the Trustees if he so wishes. It is not for me to direct WPD and the Trustees to take such action. it is a matter for them to decide.
24. Therefore, I do not uphold Mr N’s complaint.

**Anthony Arter**

Pensions Ombudsman  
20 March 2018

## Appendix

### **The consolidated version of the Rules of the Electricity Supply Pension Scheme for the Midlands category of the Central Networks Group, August 2013**

25. As relevant Rule 13, 'Entitlement to Guaranteed Minimum Pension' , says:

"(3) If a member has a Guaranteed Minimum Pension in relation to the pension for him under the Scheme in accordance with Section 14 of the Pension Schemes Act subject to any statutory provision giving flexibility to provide otherwise:

(a) the weekly rate of the pension from age 65 for a man and age 60 for a woman shall not be less than the Guaranteed Minimum;..."

26. As relevant Rule 14, 'Retirement at or after Normal Pension Age' says:

"The following Benefits shall be paid to every Member on retirement at or after Normal Pension Age, that is to say:

(a) an annual pension of 1/80th of the Member's Pensionable Salary for each year of Contributing Service with a maximum of 45/80ths; and

(b) a lump sum of 3/80ths of his Pensionable Salary for each year of Contributing Service with a maximum of 135/80ths; ..."

27. As relevant Rule 23 'pension increases', says:

"(8)...All Guaranteed Minimum Pensions payable under the Rules attributable to Earnings Factors (as defined in the pension Schemes Act) for the fiscal year commencing 6 April 1988 and for subsequent fiscal years ending with the last fiscal year that begins before 6 April 1997 shall be increased in payment by the percentages specified from time to time by orders made under section 109 of the Pension Schemes Act."

### **The Midlands Electricity Pension Scheme Members' booklet**

28. The booklet defines GMP as:

"broadly equivalent to the benefit you would have been entitled to under the earnings-related part of the State Scheme, had you not been contracted-out of it as a result of joining the MEPS. The GMP is the minimum level of benefit the MEPS must provide in order to be allowed to contract-out."

29. Under 'Additional Pension and Contracting-out' the booklet says:

"The second part of the State Pension is paid through SERPS (the State Earnings Related Pension Scheme). Employers who run good pension plans of their own may 'contract-out' of SERPS, so that instead of members receiving an Additional Pension from the State, a Guaranteed Minimum Pension broadly equivalent to the Additional Pension is paid from the company-run plan. The plan guarantees that pensions paid

on or after Normal Retirement Age will not be less than the GMP\*. Similarly, if you are married, the MEPS must provide a minimum level of pension for your spouse in the event of your death. In practice, the MEPS will provide considerably better benefits than SERPS.

\*Employment beyond State Pension Age (60 women, 65 men), will earn an increase in the amount of the GMP."

30. Under 'National Insurance Contributions' the booklet says:

"Membership of the MEPS means that you pay reduced National Insurance contributions. The saving takes account of the pension which the MEPS will provide in place of the Additional Pension."

### **The Electricity Supply Pension Scheme booklet**

31. As relevant section 15.1, 'WILL I RECEIVE A PENSION FROM THE STATE?', says

"Because you are a member of the Scheme you are "contracted-out" of the earnings related part of the State Scheme (SERPS) and pay a lower rate of National Insurance contributions. To "contract-out" the Scheme has to guarantee that the amount of your/your widow(er)'s pension will not be less than the pension which, broadly speaking, you/your widow(er) would otherwise get under the earnings related part of the State Scheme. This minimum is known as the "guaranteed minimum pension".

### **Pensions Scheme Act 1993**

32. Defines GMP as,

"'guaranteed minimum pension' means any pension which is provided, by a scheme that was a salary related contracted-out scheme, in accordance with the requirements of sections 13 and 17 to the extent to which its weekly rate is equal to the earner's or, as the case may be, the earner's widow's, widower's, surviving same sex spouse's or surviving civil partner's guaranteed minimum as determined for the purposes of those sections respectively"

33. Section 13, 'Minimum pensions for earners', as relevant says,

"(1) Subject to the provisions of this Part, the scheme must-

(a) provide for the earner to be entitled to a pension under the scheme if he attains pensionable age; and

(b) contain a rule to the effect that the weekly rate of the pension will be not less than his guaranteed minimum (if any) under sections 14 to 16.

34. As relevant Section 14 'Earner's guaranteed minimum' says,



“(1) An earner has a guaranteed minimum in relation to the pension provided by a scheme that was a salary related contracted-out scheme if in any tax week in a relevant year-

(a) earnings were paid to or for the earner's benefit in respect of employment which was contracted-out by reference to the scheme; and

(b) those earnings were in excess of the lower earnings limit for that tax week (or the prescribed equivalent if the earner was paid otherwise than weekly)...”

35. Section 109, ‘Annual increase of guaranteed minimum pensions’, as relevant says,

“(1) The Secretary of State shall in each tax year review the general level of prices in Great Britain for the period of 12 months commencing at the end of the period last reviewed under this section.

(2) Where it appears to the Secretary of State that that level has increased at the end of the period under review, he shall lay before Parliament the draft of an order specifying a percentage by which there is to be an increase of the rate of that part of guaranteed minimum pensions which is attributable to earnings factors for the tax years in the relevant period for-

(a) earners who have attained pensionable age; and

(b) widows, widowers and surviving civil partners.

(3) The percentage shall be-

(a) the percentage by which that level has increased at the end of the period under review; or

(b) 3 per cent, whichever is less.”

### **Occupation Pension Schemes (Contracting-out) Regulations 1996**

36. As relevant, Part II, 3, ‘Notices by employers of intended election’, (2) says,

“Notices given under this regulation shall be in writing and shall—

...

(g) explain (whether or not by reference to another document)—

(i) whether the employment would be contracted-out by reference to a salary-related or money purchase contracted-out scheme and how benefits would accrue to a member under the scheme if the employment were contracted-out,

(ii) how, if the employment were contracted-out, the additional pensions of State retirement pensions and widows' and widowers' benefits payable to or in respect of the earners in that employment under the Contributions and

Benefits Act, and the rates at which contributions payable by those earners under Part I of that Act, would be affected,

(iii) where further information about the scheme, State retirement pensions and the benefits mentioned in sub-paragraph (ii) can be obtained.