

## Ombudsman's Determination

Applicant	Mr R
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 R'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 R's complaint is that:
  - his Guaranteed Minimum Pension (**GMP**) has been included within his 'basic' Scheme pension, rather than paid to him in addition to it; and
  - has been funded from his employee contributions, rather than as liability on the Scheme funds.

## 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 original Employer was Midlands Electricity Board. In 1990, as part of the privatisation of the UK electricity industry, the board became Midlands Electricity plc. In 2004 it was acquired by Powergen (later rebranded as E.ON). In April 2011 E.ON's

Central Networks (the distribution network operator for the East and West Midlands) was purchased by PPL and rebranded as WPD.

6. The Scheme is a contributory arrangement funded by Employer and Employee contributions.
7. 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.
8. Mr R joined the Scheme sometime in 1972/1973. The Scheme contracted-out of the State Earnings Related Pension Scheme (**SERPS**) in the late 1970's.
9. In 2002 Mr R was compulsory retired consequent on redundancy. His pension commenced from 31 December 2002. He was then age 51.
10. Mr R reached State Pension Age (**SPA**) on 3 November 2016. Immediately prior to his SPA his total monthly Scheme pension was £1,734.48. At SPA the split of his Scheme pension was adjusted to reflect the commencement of his GMP as:

Pre'88 GMP	= £ 237.86
Post'88 GMP	= £ 157.08
Excess pension	= £1,339.54
Total	= £1,734.48 per month.
11. Mr R unsuccessfully complained to the Trustees that his GMP should be paid in addition to his monthly pension of £1,734.48.
12. At stage 2 of the Scheme's internal dispute resolution (**IDR**) procedure the Trustees said:-

- Historically most employers decided that their schemes should contract-out to benefit from paying lower National Insurance (**NI**) contributions for both the employers and employees. The trustees at the time agreed that it was in the interests of members to do so.
- The Scheme's contracted-out status was made clear in member communications such as the Member's Handbook.
- Neither WPD nor themselves "decided that the GMP element was to be deducted" from Mr R's Scheme pension (as claimed by Mr R). As Mr R's Scheme pension exceeded his GMP there was no entitlement to a further payment. An additional payment would only have been payable if his Scheme pension had been below his GMP.

- They did not decide to include Mr R's GMP in the payment of his pension; they merely calculated his benefits in accordance with the applicable law and the Rules of the Scheme.

13. Mr R says:-

- The Scheme did not have to contract-out. It was undertaken because of the financial advantage to the Employer and not because of any benefit to the Membership.
- He remained in the Scheme because he was deliberately misled as to the financial implications of contracting-out. He was not informed that the GMP would be deducted from his Scheme Pension at SPA.
- The Scheme's application of the GMP is in direct conflict with the DWP factsheet entitled 'Contracting out and why we may have included a Contracted-Out-Pension-Equivalent (COPE) amount when you used the on-line statement service' (**the DWP Factsheet**). Specifically, the factsheet says:

"In most instances your workplace or personal pension(s) will include an amount that is equivalent to the estimated COPE amount shown in your statement. This is not normally identified specifically but is paid by your pension scheme(s) as part of your total private pension."

- The Scheme should pay his GMP in addition to his Scheme pension, since it replaces the amount that would otherwise have been paid to him by the State if he had remained contracted-in.
- WPD or the Trustees do not have a legal right to fund or support the GMP/COPE element from within employees' contributions.

## Adjudicator's Opinion

14. Mr R'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:-

- The GMP is a guaranteed minimum pension. It is not a separate additional pension.
- 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 R reached SPA his pension (under Rule 14) exceeded his GMP. Consequently Rule 13 was satisfied.

- On reaching SPA Mr R'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 R says the Members' booklets failed to explain the implications of contracting-out, respectively on the member's State pension and Scheme pension.
  - 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.
  - Mr R 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.
  - Mr R says he has lost the additional State Pension that he would have received if he had not been contracted-out. However, in respect of the period for which he was contracted-out he had the benefit of paying reduced NI and his Scheme pension is well in excess of the claimed 'lost' additional State Pension.
15. Subsequent to the issuance of the Opinion, Mr R asked the Adjudicator if WPD had provided some form of confirmation that the Notice of Intention to contract-out had satisfied the requirements of Part II, 3(2), g(ii) of the 1996 Regulations, and that he had been afforded the opportunity to make a representation at that time. Mr R added that the information did not exist.
16. The Adjudicator replied:-
- Bearing in mind the significant time that had elapsed since the election it was likely to be difficult to obtain evidence either way. While Mr R said such evidence did not exist that was not sufficient for the Ombudsman to say that Members were not properly informed of the consequences of contracting-out around the time of the Notice of Intention. But even if evidence existed and the Ombudsman decided that Members had not been properly informed at that time, it was unlikely that he would find that as a result Mr R had been caused an injustice. Again because of the elapsed time it was not possible, on balance, to say what he would have done differently (if anything) at that time and that as a consequence he had been caused a financial loss by remaining an active member of the Scheme until 2002.
  - The loss Mr R was claiming was with the benefit of hindsight.

17. Mr R did not accept the Adjudicator's Opinion and the complaint was passed to me to consider. Mr R has provided his further comments which do not change the outcome. I agree with the Adjudicator's Opinion and my decision in response to the key points made by Mr R is set out below.

## **Ombudsman's decision**

18. Mr R says:

- The basis of his complaint is that he was misled about the implications of contracting-out at the time the arrangements were being set in place, specifically with regard to the effect on his SERPS/State Additional Pension. Therefore, it is necessary to obtain confirmation from WPD/the Trustees that the Notice of Intention complied with the contracting-out regulations and that representations were conducted.
- This information should also have been contained within the Scheme Rules and the Member's Handbooks.
- At the time of contracting-out the Members were informed that they would be no worse off by contracting-out.
- The injustice he has suffered amounts to the value of his "lost State Additional Pension", which was replaced by what is now a "worthless" GMP.
- His claimed loss is not by applying the benefit of hindsight. If he had been provided with the "full facts" at the time of the Notice of Intention he would not have accepted the contracting-out arrangements and thus his Scheme pension would have remained as it is today and his State Additional Pension would not have been affected.

19. Mr R says it is necessary to obtain confirmation from WPD/the Trustees that the Notice of Intention complied with the relevant contracting-out regulations and that representations were conducted before the election was made.
20. I do not consider that the information is needed, as I do not consider that Mr R has incurred any injustice.
21. Although the Statutory provisions for contracting-out have changed over the years the main requirements are contained in the PSA 1993.
22. Prior to 1988 only DB occupational pension schemes could contract-out. By contracting out the employer and the employee paid a reduced rate of 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 had they remained contracted-in. This 'promise' is known as the GMP.
23. As the Adjudicator said the GMP 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.

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24. When Mr R reached age 65 his pension exceeded his GMP. Consequently Rule 13 was satisfied.
25. I agree with the Adjudicator that the MEPS and ESPS booklets reasonably explain contracting-out.
26. Mr R says he would not have accepted contracting-out if he had been provided with the “full facts” at that time.
27. 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. In addition he would have had to pay full rate NI contributions.
28. Mr R says he has ‘lost’ the Additional State Pension that he would have received if he had not been contracted-out. But this is to ignore the benefit he has received of paying reduced NI over that period.
29. Mr R says he should not fund the provision of his GMP. But the Scheme is a contributory arrangement, funded by employer and employee contributions. Pension benefits are paid from the Scheme’s pooled Fund.
30. Therefore, I do not uphold Mr R’s complaint.

**Anthony Arter**

Pensions Ombudsman  
8 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**

31. 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;..."

32. 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; ..."

33. 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**

34. 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."

35. 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."

36. 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**

37. 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**

38. 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"

39. 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.

40. 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)...”

41. 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**

42. 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.