

Ombudsman's determination

Applicant	Mr D Ogborne
Scheme	Financial Assistance Scheme

Summary of the application

The Ombudsman has received an appeal against a decision made by the Pension Protection Fund (**PPF**) as Scheme Manager of the Financial Assistance Scheme (**FAS**) under the FAS internal review procedure. The appeal concerns the calculation of Mr Ogborne's "expected pension" by reference to the amount of annuity which was secured for him out of the assets of his former pension scheme on winding up.

Summary of the Ombudsman's determination and reasons

The Scheme Manager's decision was correct and Mr Ogborne's "expected pension" has been correctly calculated.

Background

1. Mr Ogborne was a member of the Strachan Henshaw Machinery Limited Pension Scheme (the **SHM Scheme**). He left pensionable service on 31 October 1999. The SHM Scheme commenced winding up on 4 July 2000. It qualified for the FAS on 26 January 2006 and transferred on 9 March 2012.
2. In 2002, the Trustees of the SHM Scheme entered into a buy-out arrangement with Legal & General (**L&G**). Mr Ogborne's deferred benefits were transferred to L&G and used to purchase a deferred annuity contract.
3. Under the SHM Scheme, Mr Ogborne had deferred benefits which comprised four tranches: two payable by reference to age 60 and two payable by reference to age 65. Of the two tranches payable by reference to age 60, one is a "guaranteed" entitlement payable for five years (to 6 May 2017). According to the PPF, the four tranches of pension as at 31 October 1999 were:

Element 1 £1,668.68 p.a. payable at 7 May 2012* and increased by 6.25% p.a.

Element 2 £905.32 p.a. payable at 7 May 2017 and increased by 6.25%

Element 3 £763.36 p.a. payable at 7 May 2017 and increase by 6.25%

Element 4 £372.15 p.a. payable at 7 May 2012 and increased by reference to
Section 52 Orders

*Payment end date 6 May 2017

4. FAS payments must be calculated in accordance with the Financial Assistance Scheme Regulations 2005 (SI2005/1986) (as amended) (the **FAS Regulations**). References given below relate to those Regulations. The method of determining FAS annual payments is set out in Schedule 2 to the FAS Regulations. Extracts from Schedule 2 are provided in an appendix to this document.
5. Mr Ogborne's FAS normal retirement age (**NRA**) is 60. This is age specified in the SHM Scheme Rules as the age at which he would normally have retired.
6. As a deferred member of the SHM Scheme on the day before it commenced winding up, Mr Ogborne's annual FAS payment would be calculated using the

formula - 90% of his “expected pension” less his “actual pension”. (Paragraph 4, Schedule 2) The expected pension is the aggregate of:

- the annual rate of the pension to which Mr Ogborne would have been entitled in accordance with the scheme rules had he attained his normal retirement age when the pensionable service relating to the pension ended; and
- revaluation calculated in accordance with the FAS Regulations.

7. Where a qualifying member would have received a pension or part of a pension at an age other than their NRA, it is treated as a separate pension when calculating the member’s expected pension. (Paragraph 4B, Schedule 2) Where the pension is payable at a date later than the member’s FAS NRA, it is actuarially reduced on the basis that it commenced payment on the FAS NRA. The PPF refer to this as “smoothing” and their aim is that the value of the payments made over Mr Ogborne’s lifetime will be the same as the value he would have received under the original policy.
8. The actual pension is the annual rate of annuity which has been, can be or could have been paid to Mr Ogborne as at the day from which he was entitled to an annual payment as a result of the purchase of an annuity with the assets available to discharge the liability of the scheme. (Paragraph 2(1), Schedule 2)
9. The PPF have calculated that the total of the four tranches amounts to £7,923.93 p.a. as at age 60 and 90% of Mr Ogborne’s expected pension is £7,553.03 p.a. Mr Ogborne has, therefore, not been awarded a FAS payment.
10. The PPF produced two tables showing the tranches of pension with and without smoothing.

Without smoothing

Annuity at age 60	£4,202.78
90% of expected pension	£5,533.98
FAS payment	£1,331.20
Annuity at age 65	£4,828.53

90% of expected pension £7,943.66

FAS payment **£3,115.12**

With smoothing

Annuity at age 60 £7,923.93

90% of expected pension £7,553.03

FAS payment Nil

Annuity at age 65 £4,295.05

90% of expected pension £7,622.07

FAS payment **£3,327.03**

11. Because two of the tranches are not due for payment until Mr Ogborne's 65th birthday, the PPF have applied an early payment factor of 0.902 to calculate the 90% of expected pension at age 60. The annuity figures use by the PPF are related to the annuity secured by the Trustees of the SHM Scheme in 2002 revalued to Mr Ogborne's 60th birthday. Because one the tranches of pension is due to cease on Mr Ogborne's 65th birthday, the PPF will reassess his eligibility for a FAS payment at that date. They have confirmed that this tranche has been treated as a "bridging pension". (Paragraph 4A, Schedule 2)
12. In response to a query from Mr Ogborne, L&G said that, at the date of transfer, they had predicted that he would receive a pension of £5,219.30 p.a. from age 60. This was based on an assumption of 1% for future increases in the Retail Prices Index. In correspondence with Mr Ogborne, L&G expressed the view that the PPF had "double counted" the temporary pension he was due to receive from age 60 to 65.
13. In 2005, Mr Ogborne elected to transfer his benefits from L&G and purchase an annuity from another provider. L&G paid a transfer value of £61,650.53 in respect of Mr Ogborne's Scheme benefits.
14. In the course of investigating Mr Ogborne's case, the PPF calculated a notional annuity by reference to the above transfer value. They calculated that this would be an annuity of £4,295.59 payable at Mr Ogborne's 60th birthday and valued at £4,315.99 at age 65. The PPF decided that this was not the correct approach to

take in Mr Ogborne's case. They did acknowledge, in correspondence, that it made sense and that the alternative approach (adjusting two of the tranches to age 60) resulted in them using figures which were nearly double that which Mr Ogborne was receiving at age 60.

Summary of Mr Ogborne's Position

15. Mr Ogborne submits:

- The annuity secured for him by the Trustees of the SHM Scheme is less than that used by the PPF in their calculation of his FAS payment.
- The PPF are aware that he transferred his benefits in 2005 and should calculate a notional annuity. Mr Ogborne has cited two previous decisions by the PPF Ombudsman in which this approach was taken. He has also referred to literature provided by the PPF which says,

"If you transferred your pension benefits into another pension arrangement while your original scheme was winding-up, the FAS will also convert the amount you transferred into a notional annuity ..."
- He transferred his benefits away from Legal & General before the SHM Scheme had completed winding up.

Mr Ogborne has submitted information from various sources which shows that the SHM Scheme completed winding up some time after 16 June 2005, that is, the date of the legal agreement. L&G have confirmed that Mr Ogborne elected to transfer away from them on 19 April 2005.

Summary of the PPF's Position

16. The PPF submit:

- They have used information relating to the annuity which had been arranged for Mr Ogborne before he transferred his pension rights to a different provider.
- This is the correct approach and the level of FAS assistance for Mr Ogborne is correct.

- They will conduct a recalculation of Mr Ogborne's entitlement when he reaches age 65.
- It would not be a consistent and equitable approach for all members if they were to take into account any change to the original data in relation to annuities secured.

Conclusions

17. Schedule 2 to the FAS Regulations sets out how an annual payment is to be calculated. Mr Ogborne was a deferred member of the SHM Scheme on the day before it began to be wound up. Paragraph 4 of Schedule 2 therefore applies to the calculation of his FAS payment. Paragraph 4(2) provides that Mr Ogborne's annual payment shall be 90% of his expected pension less his actual pension.
18. Mr Ogborne's expected pension, that is, the pension he would have received under the SHM Scheme Rules, is calculated by reference to two retirement ages; 60 and 65. Paragraph 4B covers pensions payable at an age other than NRA. The PPF have correctly taken Mr Ogborne's NRA to be 60 since, under Regulation 2(1A), NRA is defined as the age at which Mr Ogborne would normally have retired under the SHM Scheme. Regulation 2(1B) provides for the FAS Scheme Manager (the PPF) to determine the NRA, having regard to the SHM Scheme Rules and such other information as they consider relevant. The PPF have said that they can only calculate Mr Ogborne's annual FAS payment by reference to one NRA. In view of the specific provision made for pensions payable at some other age, I consider this to be the correct approach.
19. Paragraph 4B requires the PPF to treat the two tranches of Mr Ogborne's pension calculated by reference to age 65 as separate pensions. However, the tranches in question must be included in the amount of his expected pension. Paragraph 4B(3) then requires the application of an actuarial factor to the two tranches calculated by reference to age 65. The actuarial factor is to be determined by reference to such matters as the PPF consider relevant. They applied a factor of 0.902 to arrive at an equivalent pension figure as if the two tranches were to be paid at age 60. I find this approach to be in accordance with the requirements of Paragraph 4B.

20. I can appreciate why Mr Ogborne does not consider this to be the correct approach, because he was not due to receive the two tranches of pension in question until age 65. In his view, his FAS payment is being reduced (to nil) by reference to pension he is not receiving. However, the PPF have acted in accordance with the Regulations. The alternative would be for the PPF to treat age 65 as Mr Ogborne's NRA and uplift his other two tranches of pension. In view of the fact that one tranche was due to cease at age 65, I do not find that this was a viable alternative under the FAS Regulations. Even if it had been, it would have meant wrongly determining his NRA as being something other than the date at which he would normally have retired.
21. The PPF have confirmed that they have treated the one tranche of Mr Ogborne's pension which was due to cease at age 65 as a "bridging pension". Paragraph 4A of Schedule 2, therefore, applies. Sub-paragraph (2) provides that the PPF shall redetermine Mr Ogborne's annual payment with effect from the date on which this tranche would have ceased to be payable under the SHM Scheme Rules, that is, his 65th birthday. This is what the PPF propose to do and they expect that Mr Ogborne will, at that point, be eligible to receive an annual payment. I find this is the correct approach for the PPF to take under the FAS Regulations. I see that the PPF have made a calculation of what would have happened if the pensions had not been "smoothed" to age 60. It should be of some comfort to Mr Ogborne that, if the Regulations had not provided for smoothing, though he would have received compensation for the five years before age 65, he would have received less after age 65 than PPF calculate he will actually receive. And the additional payments after age 65 will, of course, be for life.
22. There was some suggestion in the correspondence between Mr Ogborne and L&G that the PPF might have double-counted his bridging pension. This is not the case and the suggestion may have arisen through a misunderstanding as to how the two tranches payable at age 65 were to be dealt with.
23. The second part of the equation relates to Mr Ogborne's actual pension. This is the annual rate of annuity which "has been, can be or could have been" paid to him "as a result of the purchase of an annuity with the assets available to discharge the

liability of the [SHM Scheme]”. In other words, this is the annuity (or annuities) secured by the Trustees of the SHM Scheme with L&G as a result of the Scheme winding up. It is to be determined on the basis that the assets will be or have been used to purchase an annuity at NRA and no lump sum has been/will be taken.

24. If it is not possible for the PPF to determine the annual rate of annuity on the above basis, they may determine it “on the basis of the sum which would discharge the liability of the scheme” and such other matters as they consider relevant.
25. Mr Ogborne argues that the PPF should have calculated a notional annuity because he transferred his benefits away from L&G. He has cited a previous Ombudsman decision where this approach has been taken, as well as information published by the FAS which refers to this option. I am aware that the PPF explored this possibility during their investigation of Mr Ogborne’s case. However, I do not find that this would have been the correct approach for them to take in Mr Ogborne’s case.
26. The FAS Regulations require the PPF to calculate Mr Ogborne’s actual pension by reference to the annuity which could have been paid to him as a result of the buy-out arrangement entered into by the Trustees of the SHM Scheme with L&G. This is the annuity which would have been paid to him “as a result of a purchase of an annuity with the assets available to discharge the liability of the [SHM Scheme]”. It is not relevant that the L&G annuity was bought before the winding up was completed, or that Mr Ogborne transferred away from L&G before then. What matters is whether the annuity which has been or could have been payable to him is identifiable, which it is – by reference to the L&G annuity.
27. Regulation 2(4) only comes into play if it is not possible for the PPF (as FAS Scheme Manager) to determine the rate of pension secured in this way. For example, if a beneficiary transfers away during the winding up process **and** no annuity is secured by the transferring trustees. Mr Ogborne did transfer his benefits elsewhere before the SHM Scheme had completed winding up. However, the Trustees of the SHM Scheme had already secured benefits for him with L&G who were able to supply the PPF with the necessary information. If they had not done so, there would not have been benefits with L&G for Mr Ogborne to transfer.

Determining a notional annuity on the basis of the transfer value paid by L&G in 2005 would not be the approach required by the FAS Regulations.

28. The PPF have referred to the approach taken in Mr Ogborne's case as being consistent and equitable for all members. Whilst consistency and equity are worthy principles, the PPF's prime concern must be to implement the FAS Regulations correctly. Equally, my role is to determine whether or not they have done so in Mr Ogborne's case. What the Regulations say, including any question of whether they always achieve an equitable result, is a matter for Ministers and Parliament.
29. I find that the PPF have calculated Mr Ogborne's FAS entitlement in accordance with the requirements of the FAS Regulations. I do not uphold his appeal.
30. Mr Ogborne referred to other matters in his application to me relating to the way in which his case was handled by the PPF. These matters are not within my jurisdiction and I make no finding in respect of them.

Tony King
Pension Protection Fund Ombudsman

15 December 2014

Appendix

Financial Assistance Scheme Regulations 2005 (SI2005/1986) (as amended)

Schedule 2 to the FAS Regulations contains the following provisions:

“Actual pension

- (1) In this Schedule, "actual pension" means, subject to sub-paragraphs (3) to (4) and paragraph 2A, the annual rate of annuity which has been, can be or could have been, paid to the beneficiary as at the later of-
 - (a) the day from which the beneficiary is entitled to an annual payment; or
 - (b) the day on which the qualifying pension scheme began to be wound up,as a result of the purchase of an annuity with the assets available to discharge the liability of the scheme to, or in respect of, the qualifying member after that liability has, or had, been determined ...
- (3) The annual rate of annuity which has been, can be or could have been purchased for the beneficiary for the purposes of sub-paragraph (1) ... as a result of the purchase of an annuity with the assets referred to in that sub-paragraph, shall be determined ... -
 - (a) where the beneficiary was ... a deferred member of the qualifying pension scheme on the day before the day on which the qualifying pension scheme began to be wound up, on the basis that the sum which will be, or has been, used to discharge the liability of the scheme to him will only be, or has only been, used to purchase an annuity when the qualifying member attains, or attained, his normal retirement age ...
 - (d) on the basis that there has been no commutation of benefits deriving from the scheme after the day on which the scheme began to be wound up ...
- (4) Where the scheme manager is satisfied that it is not possible for him to determine the annual rate of annuity for the purposes of sub-paragraph (1) having regard to the information available to it and to such other matters as the scheme manager considers appropriate, it shall determine the annual rate of annuity on the basis of the sum which would discharge the liability of the scheme to the beneficiary and of such other matters as it considers relevant ...”

Paragraph 4A,

“Bridging pensions

(1) This paragraph applies where -

(a) the annual rate of the pension determined for the purposes of calculating the expected pension under paragraph 3(2) or 4(2) includes an amount which, under the scheme rules, was payable for a period which is shorter than the period in respect of which the remainder of the pension was payable; and

(b) either -

(i) an annuity has been purchased for the beneficiary which provides for payment of a pension to the beneficiary at a lower annual rate from the date on which the amount referred to in sub-paragraph (1)(a) would have ceased to be payable under the scheme rules; or

(ii) a notional pension has been determined in respect of the beneficiary which includes an amount in respect of an amount which under scheme rules would be payable for a period which is shorter than the period in respect of which the remainder of the pension would be payable.

(2) Where this paragraph applies, the scheme manager shall redetermine the annual payment payable to that beneficiary with effect from the date on which the amount referred to in sub-paragraph (1)(a) would have ceased to be payable under the rules of the pension scheme.

(3) When redetermining an annual payment under sub-paragraph (2) -

(a) the annual rate of the pension for the purposes of paragraph 3(3)(a) and (c) shall be the annual rate of pension which was or should have been in payment to the qualifying member in accordance with the scheme rules in respect of rights accrued in a qualifying pension scheme less the annual amount which was payable for the shorter period referred to in sub-paragraph (1)(a), as at the day which is the day before the day on which the qualifying pension scheme began to be wound up;

(b) the annual rate of the pension for the purposes of paragraph 3(3)(b)(i) shall be the amount which was or should have been in payment to the qualifying member in accordance with the scheme rules in respect of rights accrued in a qualifying pension scheme less the annual amount which was payable for the shorter period referred to in sub-paragraph (1)(a), as at the day on which the qualifying member attained normal retirement age;

(c) the amount specified in paragraph 4(3)(a) shall be the amount determined in accordance with that paragraph less the amount which is the amount which was payable for the shorter period referred to in sub-paragraph (1)(a);

(d) the amount which was payable for the shorter period referred to in sub-paragraph (1)(a) shall be disregarded when determining the revaluation amounts; and

(e) the beneficiary shall be entitled to so much of the total amount of the annual increases determined in accordance with paragraph 9 payable to the beneficiary as at the date referred to in sub-paragraph (2) as are attributable to the amount of expected pension determined in accordance with this paragraph.

- (4) In any case where the scheme manager is satisfied, having regard to the information available to it, that it is not possible for it to determine the annual rate of pension for the purposes of sub-paragraph (3)(a) or (b) or any one of the amounts for the purposes of sub-paragraph (3)(c) to (e) it shall determine that annual rate or amount, having regard to such matters as it considers relevant ...”

Paragraph 4B,

“Pension payable at an age other than normal retirement age

- (1) This paragraph applies where any pension or part of a pension would have been payable to the qualifying member for life without actuarial adjustment under the rules of the qualifying pension scheme (disregarding any rule making special provision as to early payment on the grounds of ill health or otherwise) at an age other than the member's normal retirement age.
- (2) Where this paragraph applies -
- (a) paragraphs ... 4(3) and (3A) shall have effect as if the amount of pension or part of a pension payable at the age other than the member's normal retirement age were a separate pension;
- (b) paragraph 4(3)(a) shall have effect as if the reference to normal retirement age were a reference to the age at which the pension or part of a pension would be payable to the qualifying member without actuarial reduction under the rules of the qualifying pension scheme (disregarding any rule making special provision as to early payment on the grounds of ill health or otherwise); and
- (c) "expected pension" in paragraphs ... 4(2) means, subject to paragraph 4(4), the aggregate of the amounts calculated as the expected pension in accordance with paragraphs ... 4 in relation to any pension treated as a separate pension in accordance with paragraph (a).

- (3) An actuarial factor, determined having regard to such matters as the person determining the factor considers relevant, shall be applied to any amount determined in accordance with sub-paragraph (2)(a)."