

Commutation factors: Pensions Ombudsman determination

The Pensions Ombudsman has published his determination in a case concerning the lump sum paid to a firefighter on his retirement. The case will have relevance to many firefighters and police officers who retired in the early 2000s. This Bulletin provides an overview of the case and its implications.

Commutation

Commutation is the exchange of part, or all, of an annual pension for a cash lump sum at retirement. Commutation factors set the rate at which this exchange is made. For example, a factor of 15 means that a person receives a cash sum at retirement of £15 for every £1 of annual pension given up.

The order governing the Firemen's Pension Scheme 1992 ([the Fire Scheme](#)) and regulations governing the Police Pension Scheme 1987 ([the Police Scheme](#)) contain similar provisions relating to commutation, each requiring that the lump sum is calculated as the actuarial equivalent of the annual pension exchanged. This is in contrast to many public service pension schemes where the regulations specify a fixed commutation factor, typically a factor of 12.

The commutation factors under the Fire and Police Schemes are reviewed from time to time in accordance with their governing legislation. These reviews take account of factors affecting the actuarial equivalent value, such as changes in the discount rate used to value the benefits and the future life expectancy of retirees.

The determination made by the Pensions Ombudsman concerns historic commutation factors in the Fire Scheme and the responsibilities for maintaining and updating them. The Ombudsman's findings also have relevance to the Police Scheme given the similar commutation provisions which apply.

Background

As a large number of similar complaints had been received by the Pensions Ombudsman, he chose to consider a single case as a lead complaint. The complaint chosen was made by Mr W Milne, who retired from the Fire Scheme in November 2005. On his retirement, Mr Milne was offered the commutation terms that were in force at that time - terms which had been in force for retirements since 27 July 1998.

Both schemes' commutation factors were next reviewed in 2006. GAD provided a new table of factors on 22 August 2006 for the Fire Scheme and on 1 December 2006 for the Police Scheme. At the time, the factors were not implemented immediately but, following a High Court [judgment](#) in 2009, the revised commutation factors were backdated in the Fire and Police schemes to 22 August 2006 and 1 December 2006 respectively.

Although no analysis was available of mortality experience within the Fire or Police schemes, studies published in the early 2000s showed the life expectancy of the UK population as a whole was increasing. It could be expected that allowing for this in the commutation factors would lead to improved terms, as the annual pension given up was expected to be paid for longer and was therefore more valuable.

The focus of Mr Milne's complaint was that GAD ought to have reviewed the commutation factors earlier than 2006 and that, had it done so, more beneficial terms would have applied giving him a higher cash sum on retirement or a higher residual pension for the same amount of lump sum.

At the 1998 review, GAD had recommended that the commutation factors should be reviewed in three years' time. However, no review took place in 2001.

The Pensions Ombudsman's determination

Relying on the 2009 High Court case referred to above, the Pensions Ombudsman concluded that, since GAD had a statutory responsibility to maintain and review the commutation factors, it should have done so proactively rather than await instruction from the relevant government department. The failure to do so, he concluded, amounted to maladministration. The Pensions Ombudsman therefore upheld the complaint.

The determination finds that "an opportunity to review the commutation factors was lost in 2001/2 and then again between 2002 and 2004". The Ombudsman ordered that a new commutation factor should be prepared for Mr Milne, as if a factor review had been carried out in December 2004, with a payment made to the member to reflect the recalculated commutation lump sum. He also directed that interest should be paid on the back-dated payment and, if necessary, any tax liability arising from the additional lump sum should be reimbursed to the member.

Next steps

The Ombudsman notes that, whilst his findings in the Determination are limited to Mr Milne's complaint, the principles are the same for other retired firefighters and police officers. To avoid further cases having to be heard, he expects government to make arrangements for payments to be made to others affected, reflecting the more beneficial terms that would have applied had commutation factors been reviewed and, where appropriate, revised at the appropriate times.

GAD has prepared tables for use in the calculation of redress, based on a best reconstruction of the commutation factors which would have applied if factors had been reviewed and revised at 1 December 2001 and at 1 December 2004. The mortality and related assumptions used in the development of these tables have been reviewed by an independent firm of consulting actuaries who have confirmed that the assumptions fall within the range that GAD might reasonably have chosen if it had prepared revised commutation factors at these dates. These tables will be passed to the relevant government bodies.

GAD has also put in place internal controls to ensure that its statutory responsibilities are discharged on a timely basis in future, and specifically that scheme factors under its control are subject to periodic and timely review.

If you would like to discuss any of these issues in more detail or have any other questions please get in touch with your usual GAD contact.