



House of Commons
Public Administration Select
Committee

**Pensions Bill:
Government
Undertakings relating
to the Financial
Assistance Scheme**

Fifth Report of Session 2006–07

*Report and Appendices, together with formal
minutes*

*Ordered by The House of Commons
to be printed 10 May 2007*

The Public Administration Select Committee

The Public Administration Select Committee is appointed by the House of Commons to examine the reports of the Parliamentary Commissioner for Administration, of the Health Service Commissioners for England, Scotland and Wales and of the Parliamentary Ombudsman for Northern Ireland, which are laid before this House, and matters in connection therewith, and to consider matters relating to the quality and standards of administration provided by civil service departments, and other matters relating to the civil service.

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1 Introduction

1. On 18 April 2007 the House of Commons agreed to New Clause 38 to the Pensions Bill (Clause 18 of the Bill as first printed in the House of Lords) which increased the scope of and benefits given by the Financial Assistance Scheme (FAS) so that all members of affected pension schemes are now eligible for payments of 80% of their core pension rights up to a cap of £26,000. The Government defines eligible schemes as schemes “that started winding up between 1 January 1997 and 5 April 2005 as a result of the sponsoring employer becoming insolvent”.¹ In addition, on 18 April, the Government announced that it would also include schemes where the sponsoring employer remained solvent, “where a compromise agreement is in place and when enforcing the debt against the employer would have forced the employer into insolvency”.² It also announced that there would be a review of the use of assets in FAS pension schemes, and that this review would investigate “other credible non tax funding resources ... particularly where contributions to the scheme from external sources are deemed possible”.³

2. Our interest in this matter stems from our role as the Committee charged with examining reports from the Parliamentary Commissioner for Administration (the Parliamentary Ombudsman). As we describe below, last year the Parliamentary Ombudsman investigated the cases of those who have lost their expected pensions and found that the FAS as then constituted was not sufficient remedy for their losses. Although the improvements to the FAS are welcome, and represent a major advance from what was initially proposed, we believe the Government should still consider whether it can do more. The Bill is now before the House of the Lords, but if it is amended there it will return to this House. This Report is intended to inform Members of both Houses in further proceedings on the Bill. It contains a brief description of proposals to extend the Financial Assistance Scheme to cover those who lost pension rights when a solvent employer wound up a scheme. We have appended correspondence with the Department for Work and Pensions, and a related paper from the House of Commons Library, which we believe might assist colleagues. We are extremely grateful to the House of Commons Library, which greatly assisted us in drawing up the report.

Background

3. After the failure of the Maxwell company pension schemes, the Pensions Act 1995 introduced reforms intended to increase the security of occupational pensions. Over the years which followed, it became clear that these measures had not been as effective as had been intended. In 2004, the Government introduced a new Pensions Act, which increased prospective pensioners’ security. It established a Pensions Protection Fund (PPF), funded by a levy on the industry, which sought to reduce the risks faced by pension scheme members whose employers became insolvent. It also established a new Pensions Regulator

1 Budget 2007, HC(2006-07)342, para 5.65

2 HC Deb, 18 April 2007, c326

3 Review of the use of assets in FAS pension schemes –Terms of reference, deposited in the House of Commons Library

and set out new funding requirements for occupational schemes. The PPF began on 6 April 2005.

4. The new regime did not cover the schemes which had begun to wind up between January 1997 and April 2005 (when the 1995 Pensions Act was in force) without sufficient funds to pay benefits promised. It is estimated that some 125,000 people faced the loss of some or all their pension in such circumstances. The Government initially resisted giving assistance to members of such schemes, on the grounds that these were private sector matters. Nonetheless parliamentary pressure during the passage of the Pensions Act 2004 led it to institute a Financial Assistance Scheme (FAS) to give limited help to some of those affected.

5. Some scheme members complained to the Parliamentary Ombudsman, whose report prompted our own investigation. The essence of the Ombudsman's report was that government information about the level of protection given to members of occupational pension schemes was misleading. The 1995 Act had indeed introduced greater safeguards for holders of occupational pension schemes, but it had not removed all risks, and government information did not make it clear that risks remained. People who might have transferred assets from their employer's scheme, or taken other action to reduce those risks, were left believing that their pensions were protected. Much of that protection was based on a Minimum Funding Requirement (MFR). Insofar as scheme members were aware of the MFR, it was widely believed to be set at a level which would ensure that pension schemes were able to meet all their liabilities on wind up.

6. Although the policy intentions underlying the Minimum Funding Requirement were always clear to those in government, they were not widely communicated. As the DWP now says:

The MFR was introduced to set a minimum target level of funding for ongoing schemes, with a view to providing a reasonable chance that the assets of the scheme would be sufficient to secure the benefits accrued by scheme members in full if the scheme were to wind up. The MFR was not, however, designed to ensure (through the purchase of annuities and deferred annuities) that those benefits would be secured in full if the scheme wound up.⁴

7. In practice, the level of statutory protection given to schemes varied. On valuation, scheme assets were often found to be insufficient to meet liabilities (and where an employer was insolvent, the debt came low down the list of priorities). We were told that, as the cost of annuities rose, schemes which were wound up had to pay an increasing amount to secure pensions in payment, which had priority over other claims on the pension schemes' assets.⁵ In such cases there would be, broadly speaking, fewer assets to provide cash transfers for non-pensioner scheme members. Moreover, even when there were sufficient assets to provide transfer values to non pensioner scheme members, these were often insufficient to purchase the benefits members had been promised. In its 2003 Green Paper, *Simplicity, Security and Choice*, the DWP itself noted that "because the

4 Appendix 3 below

5 See Public Administration Select Committee, Sixth Report of Session 2005-06, *The Ombudsman in Question: the Ombudsman's report on pensions and its constitutional implications*, Ev 67

actuarial assumptions underpinning the CETV [Cash Equivalent Transfer Value] calculation have become out of date, CETV levels are now providing less protection than was originally envisaged”.⁶

The Ombudsman’s Report

8. In March 2006 the Parliamentary Ombudsman found that the inadequacy of government information amounted to maladministration, and had meant that those in occupational pension schemes had not realised the risks they ran, and had been denied the opportunity to reduce them. The Government rejected this finding, and the Ombudsman’s recommendation for redress, although it did increase the scope of the FAS.

9. Our own investigations led us to agree with the Parliamentary Commissioner, and to press the Government to increase the support available.⁷ In addition, four people who had lost their pensions judicially reviewed the Government’s rejection of the Parliamentary Ombudsman’s findings of maladministration in the High Court.⁸ The judgement in that case is being appealed by both parties, and it would be inappropriate for us to comment further.

10. In the course of our original inquiry the Ombudsman expressed her concern that the case might undermine the confidence “that citizens can have that they will receive an effective scrutiny of and outcome to their complaints”.⁹ We shared her concerns. Subsequent events have shown that the ombudsman system remains robust and effective.

11. Although the Government continues to deny that any maladministration occurred, the Parliamentary Ombudsman’s intervention has already resulted in significant improvements to the position of those whose pension funds wound up underfunded.

- Even though the Government rejected the Ombudsman’s report, it brought forward its review of the FAS in consequence, and substantially improved the scheme.¹⁰ This initial improvement was itself significant; it meant that some help was available for those within 15 years of scheme pension age, rather than being restricted only to those within three years of retirement.
- After our report and the subsequent judgement of the High Court, the Government announced that the FAS would be extended still further, so that all members of affected pension schemes would receive 80% of their core pension entitlements. That promise has resulted in the amendments to the Pensions Bill already described.

6 Simplicity, Security and Choice: Working and Saving for Retirement, Action on Occupational Pensions, Cm 5835, June 2003, Chapter 2, para 11

7 Sixth Report of Session 2005-06, The Ombudsman in Question: the Ombudsman’s report on pensions and its constitutional implications, HC 1081

8 R v Secretary of State for Work and Pensions ex parte Bradley and Others [2007] EWHC 242 (Admin), para 91 <http://www.baillii.org/ew/cases/EWHC/Admin/2007/242.html>

9 op cit, para 71

10 See HC(2005-06)1081, para 52

- The Government's review of the FAS will explore whether there are resources, other than the public purse, which can be used to increase the funds available to scheme members.

We recognize that the Parliamentary Ombudsman's report has already resulted in significant concessions from the Government, and significant improvements in the assistance available to those who have lost their pensions. The Ombudsman system has proved to be effective even in the face of Government resistance.

12. It might be argued that redress should be offered to those covered by the Ombudsman's finding of maladministration, rather than all those affected by the loss of their pensions during the period in question. We consider on this that the Government approach has been correct. The most effective response to the Ombudsman's report is to amend the Financial Assistance Scheme, particularly since some of the losses were due to policy deficiencies, which fall outside the Parliamentary Ombudsman's remit, but which Parliament can and should remedy. Our remarks apply to all those in schemes which began wind up before the regime established by the Pensions Act 2004 came into force.

2 Extension of the Financial Assistance Scheme

Unclaimed assets

13. As we noted above, the Pensions Bill, as amended by the House of Commons, has made significant improvements to the FAS. Many people, within and outside Parliament, would like a still more generous scheme; and we tabled amendments to make the benefits from the FAS equivalent to those from the Pensions Protection Fund.¹¹ The House of Commons rejected proposals for more generous benefits, to be financed by using unclaimed assets, but, as noted above, the Government has itself set up a body to review the Financial Assistance Scheme, which will "examine how we make best use of the assets in pension schemes that are winding up underfunded." The terms of reference make clear that the "review is to determine how these or *other sources of non-public expenditure funding*... could be used to increase assistance for affected scheme members" (our emphasis).¹² The review is intended "to provide an initial view in the summer and make a report to the Secretary of State by the end of 2007". This timetable makes it extremely unlikely that any proposals could be included in the current Pensions Bill. (There may be a further Bill next session, to introduce the new Personal Accounts.)¹³ **We recommend that the Government should clarify whether it intends to set aside Parliamentary time next session for any proposals from the review of the FAS which require primary legislation.**

¹¹ New Clause 26, Amendment No. 14

¹² Review of the use of assets in FAS pension schemes –Terms of reference, deposited in the House of Commons Library.

¹³ see *Security in retirement: towards a new pensions system. Summary of responses to the consultation*, Cm 6960, October 2006, Chapter 6, para 1

Schemes wound up by solvent employers

14. The FAS currently applies only to schemes which wound up on an employer's insolvency, but solvent employers were also able to wind up pension schemes, provided that they conformed to the funding requirements in place at the time. (The fact that members of schemes wound up by solvent employers were not eligible for the FAS was one of the reasons why the Parliamentary Ombudsman considered it an inadequate remedy.)¹⁴

15. The rules relating to wind up of pension schemes changed over the period covered by the Parliamentary Ombudsman's report. The key factor in determining the adequacy of schemes wound up by *solvent* employers was the amount that employers were required to contribute to buy out their debts to the scheme. Broadly speaking, the rules relating to debt owed to the scheme were as follows.

- If a scheme wound up before **19 March 2002**, the debt owed by employers to the scheme was calculated on the basis of the Minimum Funding Requirement alone, whether or not the wind up was caused by an employer's solvency. There was no distinction between monies owed in respect of pensions in payment, and in respect of prospective pensioners. However, solvent employers could only wind up their schemes if they made the required payments; when a company became insolvent the debts it owed its pensioners ranked below many other debts and might not be paid.
- Between **19 March 2002 and 10 June 2003** different rules were applied when schemes were wound up by solvent employers, and when they wound up on insolvency. When an employer was solvent the debt relating to pensioner members had to be calculated on the basis of full buyout of pension rights, but the debt relating to non-pensioners continued to be calculated on the basis of the MFR and prospective pensioners had to be provided with a "cash equivalent" transfer value. No change was made to the rules in the case of insolvent windups.
- After **11 June 2003** the debt on solvent employers was calculated on the basis of full buyout of both pensioners and non-pensioners.¹⁵

16. We tabled an amendment to bring members of schemes which were wound up by solvent employers into the FAS.¹⁶ The Minister gave assurances that the scheme would be extended to "cover members of schemes that began winding up between 1 January 1997 and 5 April 2005...when a compromise agreement is in place and when enforcing the debt against the employer would have forced the employer into insolvency".¹⁷ The amendment was not pushed to a vote, so that further discussion could take place.

17. The Government has now published further details of its proposal. As well as undertaking to extend the FAS to schemes where trustees have compromised debt to avoid insolvency, the Government has asked the review team to consider "whether there are

14 HC (2005-06) 1081, Ev 82

15 for more details see House of Commons Library Standard Note, SN/BT/3399, *Winding up a pension scheme*.

16 New Clause 25

17 HC Deb, 18 April 2006, col 326

other pensions schemes (in addition to those with compromise agreements) where although the sponsoring employer did not undergo an insolvency event, it would not be reasonable to expect the employer to have a continuing responsibility for an underfunded scheme”.¹⁸

18. In the past, the Government has maintained that, despite the regulations applying before 11 June 2003, solvent employers who have closed a scheme should remain responsible for any underfunding. As Lord Hunt of King’s Heath noted, even though the Regulations governing the FAS have been amended to ensure that no insolvent companies are excluded on technicalities, this does “not affect our oft-stated belief that ongoing solvent employers remain responsible for making good their pension promises to members”.¹⁹

19. We asked the DWP to confirm that it was correct that until June 2003 it was illegal for employers to close a pension scheme funded to the MFR even if benefits promised by the scheme could not be secured, and, if that was the case, whether trustees or scheme members would have had any legal means to ensure that full benefits were paid. The Government has told us:

No legal recourse would be available in relation to the employer debt legislation for pre 11 June 2003 wind-ups, if solvent employers had met their legal obligation to pay the debt calculated in accordance with the legislation.

Its response hints that such schemes may be counted as schemes where “it would not be reasonable to expect the employer to have a continuing responsibility to supporting an underfunded scheme”, and may be brought into the FAS as a result of its review.²⁰

After 11 June 2003, as the Government response makes clear, the regulatory and legal framework made it difficult for trustees to compromise debts to pension schemes unless the alternative would be to force an employer into insolvency. The Government has confirmed it is not aware of any schemes where debt was compromised in other circumstances.²¹ In effect, the trustees of schemes closed by solvent employers after this date were faced with a choice between forcing the company into insolvency, with consequent losses for pensioners and employees, and accepting less than was needed. It is hard to see any legal way in which trustees or scheme members could in fact ensure that employers made good their promises to scheme members.

20. We understand the Government’s unease that the taxpayer is having to provide pensions which were promised by employers and should be honoured by those employers. We also acknowledge that there is no agreed list of schemes which closed in such circumstances. Nonetheless, the problem is finite, since assistance should be limited to members of schemes which have already begun wind up.²² **Those who have lost their pension entitlements through scheme wind up by solvent companies face losses, as well**

18 Review of the Use of Assets - Terms of reference.

19 HL Deb, 7 December 2006, c1326

20 See Appendix 3

21 See Appendix 3

22 For more details see Appendix 2, p 19.

as those whose employers became insolvent. Their plight is the result of the inadequate regulatory framework in place between 1997 and 2005 (and, in particular, before June 2003). They, too, lacked clear information about the risks they ran, and had limited opportunities to avoid such losses. They can only be helped by the taxpayer.

21. The Government has said that it will ask the team reviewing the FAS, which is to report later this year, to consider the position of solvent employer schemes. That is not good enough. We urge the Government to take the opportunity offered by the Pensions Bill, and ensure that the FAS covers members of schemes wound up by solvent employers before the Pension Protection Fund came into operation.

Conclusions and recommendations

1. We recognize that the Parliamentary Ombudsman's report has already resulted in significant concessions from the Government, and significant improvements in the assistance available to those who have lost their pensions. The Ombudsman system has proved to be effective even in the face of Government resistance. (Paragraph 11)
2. We recommend that the Government should clarify whether it intends to set aside Parliamentary time next session for any proposals from the review of the FAS which require primary legislation. (Paragraph 13)
3. Those who have lost their pension entitlements through scheme wind up by solvent companies face losses, as well as those whose employers became insolvent. Their plight is the result of the inadequate regulatory framework in place between 1997 and 2005 (and, in particular, before June 2003). They, too, lacked clear information about the risks they ran, and had limited opportunities to avoid such losses. They can only be helped by the taxpayer. (Paragraph 20)
4. The Government has said that it will ask the team reviewing the FAS, which is to report later this year, to consider the position of solvent employer schemes. That is not good enough. We urge the Government to take the opportunity offered by the Pensions Bill, and ensure that the FAS covers members of schemes wound up by solvent employers before the Pension Protection Fund came into operation. (Paragraph 21)

Appendix 1: Letter from Department of Work and Pensions

10 April 2007

Financial Assistance Scheme – additional evidence

Thank you for your letter dated 29 March 2007²³ in which you asked a number of questions relating to the Financial Assistance Scheme. Please find a response to each of these questions attached in the annex.

I hope you find this information helpful. If you have any further questions please do not hesitate to contact me.

Annex

A. The estimated number of actual and potential pensioners covered by the extended scheme as announced in Budget 2007.

1. An estimated additional 100,000 individuals will benefit from the extended Financial Assistance Scheme (FAS) over time. 85,000 will be eligible for the first time, and around 15,000 of the 40,000 people who stood to benefit from FAS under the current scheme, will receive more assistance due to the latest extension.
2. As a result it is expected that all the estimated 125,000 people who have suffered losses will now receive at least 80% of their core expected pension – around three times the number who would have been helped under the current scheme.

B. A breakdown of how the Department reached the estimated “total long-term expenditure of £8bn” and details of the assumptions on which this was based. This should include the level of expenditure for each year the Financial Assistance Scheme (FAS) is assumed to be in existence into the future.

3. The table below shows the estimated annual cash cost of the extended Financial Assistance Scheme as announced in the Budget 2007.

| | | | | | | | |
|-----------|---------|---------|---------|---------|---------|---------|---------|
| | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
| Cash (£m) | 24 | 40 | 53 | 60 | 64 | 68 | 78 |
| | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
| Cash (£m) | 89 | 102 | 113 | 122 | 130 | 135 | 145 |
| | 2021/22 | 2022/23 | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 |
| Cash (£m) | 159 | 168 | 176 | 185 | 195 | 203 | 214 |
| | 2028/29 | 2029/30 | 2030/31 | 2031/32 | 2032/33 | 2033/34 | 2034/35 |
| Cash (£m) | 223 | 228 | 234 | 238 | 240 | 241 | 241 |
| | 2035/36 | 2036/37 | 2037/38 | 2038/39 | 2039/40 | 2040/41 | 2041/42 |
| Cash (£m) | 240 | 238 | 234 | 227 | 220 | 212 | 203 |
| | 2042/43 | 2043/44 | 2044/45 | 2045/46 | 2046/47 | 2047/48 | 2048/49 |
| Cash (£m) | 194 | 185 | 176 | 167 | 157 | 148 | 138 |
| | 2049/50 | 2050/51 | 2051/52 | 2052/53 | 2053/54 | 2054/55 | 2055/56 |
| Cash (£m) | 129 | 120 | 110 | 102 | 93 | 85 | 76 |
| | 2056/57 | 2057/58 | 2058/59 | 2059/60 | 2060/61 | 2061/62 | 2062/63 |
| Cash (£m) | 69 | 61 | 55 | 48 | 42 | 37 | 32 |

4. The costs presented in the table reflect the assistance levels that will be provided in the extended FAS. The scheme will ensure that the pensions of all eligible members of affected pension schemes are topped up to a level broadly equivalent to 80 per cent of the core pension rights accrued in their scheme. The cap on maximum assistance is £26,000 and there is no de minimis rule.
5. These cost estimates are based on the same model and data which we have previously used to estimate the costs of the FAS. Data were collected on the numbers and characteristics of 380 pension schemes and specific data were collected on some 1,300 members of a smaller number of schemes thought to be

reasonably representative of the total number. To estimate the cost of the FAS, these data, together with scaling parameters, have then been fed into an actuarial model to generate detailed time profiles of costs.

6. The costs are based on the following key assumptions:
- 125,000 eligible pensioner and non-pensioner members;
 - an average funding level of schemes in respect of non-pensioner members of 30-35%;
 - an average accrued pension for non-pensioner members of £3,300 per year; and
 - longevity estimates from standard tables from the UK actuarial profession's Continuous Mortality Investigation, based on the longevity experienced by pensioners whose pensions are secured with insurance companies.

C. The estimated cost in net present value terms.

7. The estimated total cost of the extended FAS in net present value terms is £1.9 billion. This is an additional £1 billion on top of the current FAS scheme.

D. The estimated additional cost of applying the same indexation rules to payments under the extended FAS as apply to the Pension Protection Fund (PPF) and details of the assumptions on which this estimate is based.

8. The PPF provides indexation on the part of an individual's pension that derives from pensionable service on or after 6 April 1997. This part will be increased each year in line with the Retail Prices Index (RPI) capped at 2.5%.
9. In order to qualify for FAS, schemes must have started winding up between January 1997 and April 2005. Data on current qualifying schemes shows that around 60% of schemes had started winding up by the end of 2002. Individuals in FAS schemes are therefore unlikely to have accrued much of their pension after 1997, and providing PPF indexation on those rights would provide them with very little additional benefit.
10. We have instead estimated the costs of providing indexation on individuals' full accrued pension. We have assumed that the pension in payment would be increased each year in line with RPI capped at 2.5%. The additional cash cost, on top of the current FAS would be £3.5 billion (£530 million in NPV terms).
11. These costs are based on the same assumptions as in [B] above, but assuming that payments are increased at 2.5% in each year.

E. The estimated additional cost of providing people eligible for the extended FAS with the same compensation that would be available to them were they eligible for the PPF, and details of the assumptions on which this estimate is based.

12. The estimated additional cost of providing people eligible for the extended FAS with the same compensation that would be available to them were they eligible for the PPF is £2.7 billion in cash terms (£640 million in net present value terms).
13. These costs are based on the same assumptions as in B above, but with different assumptions regarding the parameters of the scheme:
 - Individuals receive 90% of their core pension (100% if they were already pensioners when their scheme started to wind up).
 - The compensation cap is set at PPF levels.
 - Indexation is provided on benefits accrued after 1997 only (RPI capped at 2.5%). As we do not hold data on when members accrued their rights, we have assumed that only a small proportion of rights will have been accrued after 1997 (as explained in the answer to D above). We have therefore applied 1% indexation across the board as a proxy for the PPF indexation rules. If anything, this overestimates the amount of indexation individuals are likely to be paid.

F. The estimated cost of extending FAS to people whose pension funds wound up before April 2005, where the sponsoring employer has not experienced an insolvency event and details of the assumptions on which this is based.

14. We are unable to estimate the cost of including all schemes that have wound up under-funded with a solvent employer, as there is very limited data on the numbers and circumstances of such schemes. The issue of schemes with solvent employers is complex, as many members of such schemes will have suffered small losses, if any loss at all (for example, where wind up is due to a merger of schemes and members are transferred to a different scheme providing the same benefits).
15. We do, however, have data on a specific group of schemes with solvent employers – those where the employer has compromised the debt on the pension scheme in order to avoid an insolvency event. We have been made aware of around 15 such schemes with around 8,000 members in total.
16. Assuming that these schemes are similar to the average FAS scheme (i.e. using the same assumptions as in [B] above), we estimate that the cost of including them in the extended FAS would be around £460 million in cash terms (£110 million in net present value terms).

Appendix 2: Note prepared by the House of Commons Library

I understand that in the light of the announcement in Budget 2007 of a further extension of the FAS,²⁴ you would like further information on the following questions:

1. The difference between benefits provided under PPF and what is now being proposed under the extended FAS.
2. An explanation of what £8bn figure referred to in the Budget amounts to and the difference between the figures presented in cash terms or net current value terms.
3. What it would cost to provide PPF level of benefits to those now eligible for FAS.
4. What it would cost to index-link payments under the extended FAS.
5. What it would cost to cover those who lost out when a solvent employer walked away from a scheme.

Scope of the FAS

To qualify for the FAS an occupational pension scheme must not be a money purchase scheme and must have commenced wind up between 1st January 1997 and 5th April 2005. Except in certain limited circumstances, the employer relating to the scheme must also experience an insolvency event (dealt with in more detail below).²⁵ Initially, eligibility for the FAS was restricted to those within three years of retirement age on 14 May 2004. In 2006, this was extended to those within fifteen years of retirement age on that date, with the amount of assistance depending on how far a person was from normal retirement age, up to a maximum of 80%, subject to a £12,000 cap.²⁶ In Budget 2007, the Chancellor announced a further extension of the FAS, so that all members of affected pension schemes would get:

80 per cent of the core pension rights accrued in their scheme. The cap on maximum assistance will be increased to £26,000 and the de

²⁴ HM Treasury, Building Britain's long-term future: Prosperity and Fairness for Families, Budget 2007, para 5.65; http://www.hm-treasury.gov.uk/media/73B/6B/bud07_chapter5_320.pdf (retrieved 27 March 2007). See also, HC Deb, 28 March 2007, c113WS

²⁵ DWP, The FAS, An in-depth guide for trustees and professionals, April 2007, <http://www.dwp.gov.uk/lifeevent/penret/penreform/fas/fas-p2-apr-07.pdf>

²⁶ FAS Regulations 2005/1986, Schedule 2, para 3(3) and 4

minus rule that excludes those whose FAS payment would be £10 or less a week will be removed.²⁷

The FAS continues to be criticised as insufficiently generous. One of the reasons for this is that it provides 80% of “core pension rights,” whereas the Ombudsman asked the Government to consider the replacement of the entirety of the pension which affected individuals would have received – non-core, as well as core benefits.²⁸ Ros Altmann argues that the 80% of core pension that the FAS provides “is not 80% of expected pension – it is worth around 60%.”²⁹ “Core benefits” are, broadly speaking, the monthly payments individuals would have received from their pension on retirement. “Non-core benefits” include the option to take a proportion of the pension as a lump sum, survivor’s benefits, and ill-health benefits (i.e. the ability to draw a full pension early on ill-health grounds).³⁰ The Department has estimated that implementing the Ombudsman’s proposals would cost between £13 billion and £17 billion over 60 years in cash terms.³¹

How the costs are presented

Originally, the Government provided £400 million in cash terms (£243 million in net present value terms) for the FAS over 20 years.³² The extension of the scheme announced in May 2006, to those within fifteen years of pension age on 14 May 2004, increased the commitment to £2.3 billion in cash terms (£830 million in net present value terms). The further extension announced in Budget 2007, increased the commitment to £8 billion in cash terms (£1.9 billion in net present value terms).³³

The figures given in the breakdown DWP has provided for the Committee show the cost of the extended FAS announced in the 2007 Budget in cash over 55 years from £2007/08.³⁴ The annual amounts for all years to 2062/63 sum to £8 billion. DWP explains that:

Net present value is used to compare costs that occur in different time periods. It is a separate concept to inflation and is based on the principle

27 HM Treasury, *Building Britain’s long-term future: Prosperity and Fairness for Families*, Budget 2007, para 5.65

28 DWP, ‘Response to the Report by the Parliamentary Ombudsman, Trusting in the pensions promise’, June 2006

29 Press release, ‘More political spin – how mean-spirited can the Government be?’, 21 March 2007. Her statements are based on detailed calculations of what individuals would get under FAS compared to the situation if their pension scheme had not wound up

30 DWP, ‘Response to the Report by the Parliamentary Ombudsman, Trusting in the pensions promise’, June 2006, Annex, page 40

31 DWP, Response to the Report by the Parliamentary Ombudsman, ‘Trusting in the Pensions Promise’, June 2006 <http://www.dwp.gov.uk/publications/dwp/2006/pensions/response-ombudsman.pdf>

32 HC Deb, 14 May 2004, c32WS; SC Deb, 6 December 2006, c4

33 HC Deb, 28 March 2007, c113WS

34 Paragraph 3, DWP letter to committee

of ‘time preference’, i.e. that people prefer to receive goods and services now rather than later. NPV costs discount cash costs by 2.5% per year to convert cash costs into real costs (to take account of inflation) and, in addition, by 3.5% a year in years 0-29, and by 3% a year in years 30 onwards to convert real costs into NPV costs (to take into account time preference).³⁵

The effect of applying these figures to the cost of the extended FAS is to get a net present value of just under £2 billion. The main reason for such a big difference between the cash and net present value figures is the 55 years over which the scheme is costed. As an example, £100 in 2007/08 would have a purchasing power of around £25 by 2062 if inflation had been 2.5% on average a year. Applying a discount rate (the opportunity cost of capital) adds to the disparity.

Mr Justice Bean, in his decision on the application for judicial review of the Ombudsman’s report on occupational pensions, said he considered the difference between the cash costs and net current value costs to be important as “a matter of presentation”, although “not in truth a difference of substance.” A more telling point, he said was that:

neither figure takes account of the tax that would be payable by the recipients of pensions if full payments are restored, nor the benefits that have to be paid to those who have lost all or most of their occupational pensions on winding-up.³⁶

The Department has said that the increased tax revenue and reduced income-related benefit expenditure which would arise is “difficult to estimate precisely, over such a long period.”³⁷

Differences between Pension Protection Fund (PPF) and FAS

It should be noted that, like the FAS, the PPF does not compensate members for the full amount of their expected pension. However, it is more generous than the FAS. The main differences between the two schemes are, in broad terms, as follows:

- PPF replaces 100% of the pension in payment to those of at least normal pension age for the scheme on the assessment date, and 90% of the expected core

³⁵ DWP, Response to the Report by the Parliamentary Ombudsman, ‘Trusting in the Pensions Promise’, June 2006, p 44 <http://www.dwp.gov.uk/publications/dwp/2006/pensions/response-ombudsman.pdf>

³⁶ R v Secretary of State for Work and Pensions ex parte Bradley and Others [2007] EWHC 242 (Admin), para 91 <http://www.bailii.org/ew/cases/EWHC/Admin/2007/242.html>

³⁷ DWP, Response to the Report by the Parliamentary Ombudsman, ‘Trusting in the Pensions Promise’, June 2006, Annex, para 23, <http://www.dwp.gov.uk/publications/dwp/2006/pensions/response-ombudsman.pdf>

pension for those below normal pension age.³⁸ FAS will top up pension payment to 80% of expected core pension.³⁹

- For people below normal pension age, the 90% compensation provided under PPF is subject to a cap of £26,935.70 at age 65.⁴⁰ The amount of the cap is increased annually in line with earnings. FAS payments are subject to a cap of £26,000.⁴¹
- Under both schemes, survivors are entitled to roughly half of what the scheme member would have been entitled to.⁴² Survivors' benefits are therefore less generous in FAS than the PPF.
- In the PPF, that part of compensation relating to pensionable service on or after 6 April 1997 is increased in line with the RPI, capped at 2.5%.⁴³ FAS payments are not index-linked "because many of the schemes involved were not index linked in the first place."⁴⁴
- Eligibility for the PPF starts from normal pension age for the scheme.⁴⁵ Eligibility for the FAS starts at age 65, (except where a person is terminally ill).⁴⁶
- Trustees can make pension payments at PPF levels (90% and 100%) during the assessment period.⁴⁷ The FAS scheme manager has the discretion to provide those eligible for FAS with "interim" payments, up to only 80% of the expected pension.⁴⁸
- PPF provides an option to draw up to 25% of the value of their compensation as a tax free lump sum.⁴⁹ There is no such option in the FAS.⁵⁰

Additional costs of providing PPF level benefits to those eligible for the FAS

DWP estimates that the additional cost of providing people eligible for the extended FAS with PPF level benefits is £2.7 billion in cash terms (£640 million in net present value terms.) This assumes that people get PPF level of benefits (90% or 100%), the cap is set at PPF levels, and indexation is provided on benefits after

38 Pensions Act 2004, Sch 7, para (4), PPF, Introductory Guide to the Pension Protection Fund, p5

39 FAS Regulations 2005/1986, Sch 2, para 3(3) and 4

40 Pensions Act 2004, Sch 7, para 27; Explanatory Memorandum to Pension Protection Fund, (Pension Compensation Cap) Order 2007, SI 2007 No. 989, para 4.8

41 MGP 07/1230

42 Pensions Act 2004, Sch 7, para 4; FAS Regulations 2005 (SI 2005/1986), Sch 2, para 5

43 Pensions Act 2004, Sch 7, para 28

44 HC Deb, 28 February 2005, c628

45 Pensions Act 2004, Sch 7, para 11 (1) and 15 (1). There is an option to apply for PPF payments from age 50, but the amount is actuarially reduced. Applications to PPF can be made from age 50, although payments will be actuarially reduced

46 FAS Regulations (SI 2005/1986), reg 17 (2)

47 <http://www.pensionprotectionfund.org.uk/index/assessment-period.htm>

48 FAS Regulations 2005 (SI 2005/1986), Sch 2, para 10; Proposed Government amendment to Pensions Bill 2006, NC38

49 Pensions Act 2004, Sch 7, para 11(1) and 15 (1)

50 DWP, The FAS – an indepth guide for trustees and pension professionals, p 3
<http://www.dwp.gov.uk/lifeevent/penret/penreform/fas/information.asp>

1997 (1% indexation across the board has been assumed).⁵¹ It should be noted that this is the estimated cost of bringing FAS benefits up to PPF levels, rather than of bringing FAS into line with PPF in all respects.

Additional costs of indexing payments under the extended FAS

DWP was asked to provide an estimate of the additional cost of applying the same indexing rules to payments under the extended FAS as apply to the PPF. Instead, it has provided an estimate of indexing the full accrued pension. It explains that this is because the PPF provides indexation on the part of the pension that derives from pensionable service on or after 6 April 1997. Because individuals in FAS schemes are unlikely to have accrued much of their pension after 1997, providing indexation on those rights would provide them with little additional benefit.⁵² For this reason, DWP says that:

We have instead estimated the costs of providing indexation in the individual's full accrued pension. We have assumed that the pension in payment would be increased each year in line with RPI capped at 2.5%. The additional cash cost, on top of the current FAS would be £3.5 billion (£530 million in NPV terms).⁵³

Solvent employers

In order to qualify for the FAS the employer must usually have experienced an 'insolvency event' by 31 August 2007.⁵⁴ The date by which an insolvency event must have been experienced has recently been extended. The Pensions Reform Minister, James Purnell, said this was because he had received representations from trustees of a small number of pension schemes who were in negotiation with employers in relation to insolvency and would like further time to complete the process. He said he would consider whether a further extension beyond 31 August was required.⁵⁵ The definition of "employer insolvency" for FAS purposes is designed to be "sufficiently general ... to capture schemes where the sponsoring employer no longer exists and also where insolvency may have occurred some time after scheme wind-up had started." The definition was extended by amending regulations which came into force in December 2006.⁵⁶ These allow the FAS to:

51 Letter from DWP to Clerk of the Committee, dated 10 April 2007, para 12-13

52 Ibid, para 9

53 Ibid, para 10

54 HC Deb, 27 February 2007, c84WS

55 HC Deb, 27 February 2007, c84WS

56 FAS (Miscellaneous Amendment) Regulations 2006 SI 3370

consider schemes where the employer has been subject to overseas insolvency proceedings, and further, they give a discretionary power to include schemes where the employer is unlikely to continue as a going concern but for whatever reason has not formally undergone a qualifying insolvency event.⁵⁷

In debate in the House of Lords, Lord Hunt of King's Heath said that the amendments:

demonstrate our desire to define insolvency as widely as possible in order to bring schemes and their members into the FAS. They do not affect our oft-stated belief that ongoing solvent employers remain responsible for making good their pension promises to members.⁵⁸

DWP was asked to estimate the cost of extending the FAS to people whose pension funds wound up before April 2005, where the sponsoring employer had not experienced an insolvency event. DWP says that there is limited data on the number and circumstances of schemes that have wound up under-funded with a solvent employer. It also argues that some will have suffered small losses (if any at all), for example where the wind up is due to the merger of schemes and members are transferred to a different scheme providing the same benefits. DWP has, however, provided an estimate of the cost of including a specific number of schemes where the debt has been compromised in order to avoid insolvency of the employer.⁵⁹ The context within which this would happen is set out below.

Where a decision is taken to wind up a pension fund, a valuation is made of the pension fund's assets and liabilities. Where the fund is found to be in deficit, any shortfall is treated as a debt due from the sponsoring employer to the trustees of the scheme under section 75 Pensions Act 1995.⁶⁰ Prior to June 2003, the valuation of the fund was done on a Minimum Funding Requirement (MFR) basis and non-pensioner members were required to be put in a position where they would receive the Cash Equivalent Transfer Values (CETV) that would normally be paid in the case of someone who left the company. DWP's 2003 Pensions White Paper commented that these CETVs were too low to provide people with the pensions they expected at retirement:

Companies that choose to wind up their schemes pass their investment risk on to non-pensioner members, as they transfer their money into

57 Explanatory Memorandum to FAS (Miscellaneous Amendment) Regulations 2006 SI 3370 http://www.opsi.gov.uk/si/em2006/uksiem_20063370_en.pdf

58 HL Deb, 7 December 2006, c1326

59 Ibid, para 14-16

60 Section 75, Pensions Act 1995

money purchase arrangements. Moreover, because the actuarial assumptions underpinning the CETV calculation have become out of date, CETV levels are now providing less protection than was originally envisaged.⁶¹

For this reason, the Government introduced a requirement through Pensions Act 2004 to ensure that there were sufficient funds to meet the full costs of the rights accrued by scheme members. Since June 2003, any deficit is determined by valuing the benefits pension scheme members would get on a basis that they are bought out in full via immediate annuities (for pensioners) or deferred annuities (for non-pensioners).⁶²

In some cases the employer is not in a position to meet its debt to the pension scheme. The courts have held that it can be permissible for the trustees, exercising their fiduciary duties, to agree a lower amount – or “compromise” the employer’s debt to the scheme, if this is to the benefit of pension scheme members. In the case of the *Bradstock Group Pension Scheme*, for example, the scheme was in substantial deficit and the employers had no realistic prospect of being able to pay the instalments necessary to bring the funding up to the required level by the prescribed date. Unless the debt could be compromised, the employers would be forced into liquidation. The court held it was permissible to compromise a debt for the benefit of scheme members.⁶³

DWP says it is aware of 15 schemes where the employer has compromised the debt on the pension scheme in order to avoid an insolvency event. It estimates that these schemes have around 8,000 members in total and that the cost of including them in the extended FAS would be £460 million in cash terms (£100 million in net present value terms).⁶⁴ Trustees should only agree to compromise a debt in the interests of scheme members. In the cases to which DWP refers, the decision would have been taken well before the recent extensions of the FAS. It is possible that had they been aware at the time of what would be available for pension scheme members under the FAS, they might have made a different decision. They might for example, have decided that it would be in the interests of scheme members for the employer to be forced into insolvency, bringing them within the scope of the FAS.

61 DWP, *Simplicity, security and choice: Working and saving for retirement. Action on occupational pensions*, para 11Cm 5835, June 2003

62 Pensions Act 2004, Occupational Pension Schemes (Winding Up and Deficiency on Winding Up etc) (Amendment) Regulations 2004 (SI 2004/403)

63 Tolley’s Pensions Law, para H4.18

64 Letter from DWP to Clerk of the Committee, dated 10 April 2007, para 14-16

Appendix 3: Correspondence between the Clerk and DWP

Letter from the Clerk of the Committee to the Parliamentary Liaison, DWP

25 April 2007

The Public Administration Select Committee has asked me to clarify the Government's intentions on extending the Financial Assistance Scheme to cover cases in which solvent companies have wound up their schemes, and trustees have compromised the depths, in order to avoid insolvency. In the debate on 18th of April, the Minister said assistance would be given:

“when a compromise agreement is in place and when enforcing the debt against the employer would have forced the employer into insolvency.” (c 326)

In papers deposited in the House of Commons Library the Government says one of the aims of its review will be to “determine whether there are other pension schemes (in addition to those with compromise agreements) where although the sponsoring employer did not undergo an insolvency event, it would not be reasonable to expect the employer to have a continuing responsibility for supporting an under funded scheme”.

The Committee's understanding is that the law relating to the closure of pension schemes by solvent employers changed several times during the period between the passage of the Pensions Act 1995, and the establishment of the Pensions Protection Fund. They have asked me to clarify the following points.

- Is it correct that until 11 June 2003 it was legal for employers to close a pensions scheme funded to the MFR, even if the benefits promised by the scheme could not be secured?
- If so, would trustees or members have any legal means by which they might ensure full benefits were paid?
- Does the DWP have any indication of the number of schemes which wound up in such circumstances?
- Is it correct that, under the criteria are currently proposed, members of schemes such as those run by Daybrook Laundry, Rael Brook, LGG Charlesworth and Moores Products would not qualify for assistance?
- What legal recourse might trustees or scheme members have in respect of schemes run by solvent employers which closed without the funding required to secure expected benefits **after** 11th June 2003?
- Are you aware of any circumstances in which pension scheme trustees compromised debt after 11th of June 2003 in circumstances where enforcing the debt would **not** have risked causing employer insolvency?

I would be very grateful for an answer to this letter by close of play on Wednesday 3rd May. I am sorry for the short deadline, but the Committee wishes to consider this matter urgently.

Response from the DWP

9 May 2007

**FINANCIAL ASSISTANCE SCHEME – ADDITIONAL EVIDENCE
FOR THE PUBLIC ADMINISTRATION SELECT COMMITTEE**

Is it correct that until 11 June 2003 it was legal for employers to close a pensions scheme funded to the MFR, even if the benefits promised by the scheme could not be secured?

1. Yes, broadly speaking. From April 1997 until 18 March 2002, the debt payable by a relevant solvent employer on the wind-up of their scheme was based on the Minimum Funding Requirement (MFR) for all scheme members. From 19 March 2002 to 10 June 2003, the debt calculation for pensioner members (only) was increased to a ‘full buy-out’ level. Prior to April 1997, the debt was based on a scheme specific calculation of transfer values.

2. The MFR was introduced to set a minimum target level of funding for ongoing schemes, with a view to providing a reasonable chance that the assets of the scheme would be sufficient to secure the benefits accrued by scheme members in full if the scheme were to wind up. The MFR was not, however, designed to ensure (through the purchase of annuities and deferred annuities) that those benefits would be secured in full if the scheme wound up.

If so, would trustees or members have any legal means by which they might ensure full benefits were paid?

3. No legal recourse would be available in relation to the employer debt legislation for pre 11 June 2003 wind-ups, if solvent employers had met their legal obligation to pay the debt calculated in accordance with the legislation.

Does the DWP have any indication of the number of schemes which wound up in such circumstances?

4. No. As your letter notes, the review of pension scheme assets has been asked to determine whether there are other pension schemes (in addition to those with compromise agreements) where although the sponsoring employer did not undergo an insolvency

event, it would not be reasonable to expect the employer to have a continuing responsibility for supporting an under funded scheme

Is it correct that, under the criteria currently proposed, members of schemes such as those run by Daybrook Laundry, Rael Brook, LGG Charlesworth and Moores Products would not qualify for assistance?

5. If the schemes listed have not been subject to compromise agreements in circumstances when enforcing the debt against the employer would have forced the employer into insolvency, then they are not included within the strict terms of the proposed extension.

6. However, by means of the review, we are looking into the circumstances of such schemes and invite representations on behalf of any scheme members who fall outside of current FAS rules and who are faced with significant pension losses. Submissions can be made to the review via the following email address: adelphi.fas-review@dpw.gsi.gov.uk

What legal recourse might trustees or scheme members have in respect of schemes run by solvent employers which closed without the funding required to secure expected benefits after 11th June 2003?

7. After 11 June 2003, the debt payable by a solvent employer on wind-up of their scheme was set at 'full buy out'. This broadly equates to the full costs of winding up and the full benefits that all scheme members (both pensioners and deferred) have accrued and expect to receive.

8. However, trustees are able to reach a compromise agreement with the principal employer to the scheme. But trustees of schemes have a fiduciary duty to act in the interests' of all the scheme members and beneficiaries at all times.

9. Trustees are responsible for running their pension schemes and any compromise agreements made are scheme and employer specific. Trustees should believe that they have taken the best decision available to them, having taken account of the position of their scheme. We would expect trustees and employers to discuss all of their options open to them before taking the decision to wind up their pension scheme

10. Before 6 April 2005, Opra could investigate compromise agreements and were prepared to intervene where there was evidence that the trustees may have agreed to an unnecessarily low settlement or where they had not taken appropriate steps prior to reaching an agreement with the employer.

11. Since 6 April 2005, any compromise of the debt due to the pension scheme is a notifiable event and must be notified to the Pensions Regulator. The Pensions Regulator is a risk based regulator and based on the individual circumstances of the case, may consider seeking to use its powers where there is evidence that the trustees have not acted in the best interest of members or where there is evidence that there has been a deliberate act or failure to act to avoid pension scheme liabilities. A compromise agreement is a 'type A' event, as

described in the regulatory guidance, for which it may be appropriate and advisable to seek Clearance.

Are you aware of any circumstances in which pension scheme trustees compromised debt after 11th of June 2003 in circumstances where enforcing the debt would not have risked causing employer insolvency?

12. We are not aware of any such cases. Any such cases would fall outside of the strict terms of our proposed extension. Representations on behalf of any members of any such schemes could be made to the review.

Formal Minutes

Thursday 10 May 2007

Members present:

Dr Tony Wright, in the Chair

David Burrowes
Paul Flynn
David Heyes
Kelvin Hopkins

Mr Ian Liddell-Grainger
Julie Morgan
Mr Gordon Prentice
Mr Charles Walker

Draft Report [*Pensions Bill: Government Undertakings relating to the Financial Assistance Scheme*], proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 21 read and agreed to.

Resolved, That the Report be the Fifth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Several papers were ordered to be appended to the Report.

[Adjourned till Tuesday 15 May at 3.50 p.m.]

Reports from the Public Administration Select Committee since 2005

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

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| Seventh Report | The Ministerial Code: the case for Independent Investigation | HC 1457 |
| First Special Report | The Attendance of the Prime Minister's Strategy Adviser before the Public Administration Select Committee | HC 690 |
| Second Special Report | Ministerial Accountability and Parliamentary Questions: Government Response to the Committee's Fifth Report (Session 2004-05) | HC 853 |
| Third Special Report | Inquiry into the Scrutiny of Political Honours | HC 1020 |