The Financial Assistance Scheme and Pension Protection Fund (Valuation, Revaluation and Indexation Amendments) Regulations 2011 – Government response to consultation on draft regulations

Part 2: The Pension Protection Fund (Revaluation Amendments) Regulations 2011

March 2011

Department for Work and Pensions

Contents

Introduction

1. Between 12 August 2010 and 3 November 2010, the Department for Work and Pensions (DWP) undertook a consultation exercise on draft Regulations intended to deliver most of the changes for the Pensions Protection Fund (PPF) and the Financial Assistance Scheme (FAS) required in order for payments to be increased in relation to the consumer prices index (CPI) in future.

2. This document is the second part of the Government's formal response to the consultation. It presents the main points made by respondents in relation to the PPF aspects of that consultation and provides the Government's response to those points.

3. The Government published the first part (Part 1) of its response to the consultation on 7 February this year. It focused primarily on issues relating to the Financial Assistance Scheme. However, it also provided a response to comments on general issues which spanned both the FAS and PPF proposals such as the appropriateness of the CPI measure. The response can be found here – http://www.dwp.gov.uk/consultations/2010/fas-ppf-regs-2011.shtml. As Part 1 of the Government's response provides comprehensive answers on the general issues mentioned in consultation, this document does not revisit these points in detail but focuses on the PPF specific aspects of the proposals.

The consultation

4. The proposed changes would amend:

   - the PPF rules so that accrued pensions would be revalued by reference to the RPI for periods before 31 March 2011 and could be revalued by reference to the CPI after that date. Relevant caps to revaluation increases would continue to apply as they do under current rules.
   - the section 143 funding test applied by the PPF to relevant schemes.

5. Changes were also proposed to the indexation of relevant PPF payments so that such increases could be undertaken in line with the CPI in the future. These changes require amendments to primary legislation and are being taken forward via the current Pensions Bill. Subject to Parliamentary agreement, the Government intends that PPF indexation payments paid on 1 January 2012 will be based on increases in the CPI, subject to the cap.

6. The consultation document also discussed the synthetic buy-out bases used by the PPF and the FAS which seek to estimate the cost of securing bulk annuities.

Overview of consultation responses

7. DWP received 46 responses on the PPF and FAS issues for consultation from a mixture of members, their representatives and pensions' professionals A list of respondents is provided in Part 1 of the Government's response to the consultation, so it is not repeated in this document.

8. DWP is grateful for the responses received.

9. Respondents' views on the proposed PPF changes can be broadly summarised as follows:

    - Scheme members and members' representatives, including Unions and the Pensions Action Group, were mainly focused on the FAS changes, although they were opposed to the use of the CPI in general as they felt that this would deliver lower increases over time than the RPI and was intended to save the PPF and sponsoring employers money.

    - Pensions professionals' views on the proposed change to the CPI were broadly neutral as they felt that decisions around the appropriate measure of inflation were for the Government to make. Overall, comments from this group focused on the development of the CPI-linked investment and buy-out market and its potential impact on the proposals in respect of the section 143 test applied by the PPF.

Summary of the changes to the Regulations

10. The legislative changes in respect of PPF revaluation have not changed significantly from the consultation draft but the DWP has made some minor changes to the drafting of these Regulations.

11. The most significant alterations to the consultation draft are:

    - the removal of the draft provision in respect of the application of section143 funding test to schemes funded close to 100 per cent on this basis that have entered a PPF assessment period before the new CPI-based provisions come into force. This provision has been removed after respondents indicated that the provision would be difficult to apply in practice, and would be unlikely to be of benefit to the small number of schemes it was designed to help.

- the separation of the FAS and the PPF changes into two Regulatory packages, although, subject to Parliamentary approval, it is still anticipated that both sets will come into force by the end of March 2011. The change has been made in order to assist understanding of the separate sets of changes and to allow both sets of draft Regulations to undergo Parliamentary scrutiny in sufficient time for them to come into force by 31 March.

12. The Pension Protection Fund (Revaluation Amendments) Regulations 2011 have now been laid before Parliament. They can be found at: http://www.legislation.gov.uk/ukdsi/2011.

13. An accompanying Equality Impact Assessment is available on the DWP website – http://www.dwp.gov.uk/consultations/2010/fas-ppf-regs-2011.shtml

14. An impact assessment for the PPF indexation change was prepared for the Pensions Bill. The figures used in that Impact Assessment to reflect the impact on business included the impacts of both the revaluation and indexation changes. It can be found here – http://www.dwp.gov.uk/policy/pensions-reform/

15. The finalised PPF Regulations and accompanying Explanatory Memorandum will be available on the Office of Public Sector Information's website at: http://www.legislation.gov.uk/uksi/2011

16. The Financial Assistance Scheme (Revaluation and Indexation Amendments) Regulations 2011 were laid before Parliament on 31 January. They can be found at: http://www.legislation.gov.uk/ukdsi/2011

The consultation

Changes to the Pension Protection Fund

17. This section covers the comments on the Pension Protection Fund (PPF) questions posed in the consultation, and sets out the Government's view on these issues.

18. The PPF-specific questions in the original consultation ran from Q1 to Q4. As this response is concerned only with that part of the consultation the commentary is limited to those questions.

Q1. The Government welcomes views on the change to the PPF revaluation provisions.

19. This part of the consultation document set out the Government's proposals to amend the PPF's revaluation rules so that accrued pensions would be revalued by reference to the RPI for periods before 31 March 2011 and could be revalued by reference to the CPI after that date. The revaluation across the whole revaluation period (including any period that spans the date the draft Regulations come into force) would be subject to the same caps as under current rules (either 2.5 per cent per annum compound or 5 per cent per annum compound depending on periods for which the pension accruals relate).

20. Very few respondents commented specifically on this question although there was some overlap with the general comments on the appropriateness of using the CPI inflation measure for relevant increases to PPF and FAS payments. Overall, these respondents felt that the move to using the CPI was a backward step which undermined the level of protection put in place by the previous Government.

21. Some respondents stated that the CPI-linked revaluation should only apply to accruals after the change comes into effect and only where this would have been the case on the original scheme rules.

The Government's response

22. The Government appreciates that some respondents object to the switch to using the CPI. The move to using the CPI in respect of the PPF is not in order to reduce the liabilities of sponsoring employers of occupational pension schemes. The Government recognises that many occupational defined benefit schemes are facing financial pressures and that the PPF has indicated that it will be reducing the pension protection levy for 2011/12, partly in response to the reduced liabilities it is likely to need to

meet in relation to change to the CPI. Such a reduction in the levy will obviously be helpful to schemes.

23. The reasons why the Government believes that the CPI is an appropriate index have been explained in the opening section of Part 1 of the Government's response which was published on 7 February. In summary:

    - it is the headline measure of inflation in Great Britain;
    - it does not include mortgage interest payments, which are not relevant to the majority of pension and PPF recipients.
    - it uses a more appropriate methodology which takes account of consumers trading down to cheaper goods when prices rise.
    - it provides consistency and clarity through the application of a single index.

24. As was made clear in the Government's earlier response, the decision to amend the PPF regulations is part of a wider decision to use the CPI instead of the RPI as the Government's general measure of inflation for social security benefits, State pensions, public sector pensions, statutory minimum revaluation and indexation of private sector pensions and Assistance paid by the Financial Assistance Scheme.

25. The Government believes it would be inappropriate to use a different measure for the PPF – which provides help to members of some failed occupational pension schemes – than for the statutory measure applying to ongoing pension schemes.

26. Whilst the Government appreciates that respondents are concerned by the proposed changes, it feels that the CPI is a better general measure of price inflation and that it is reasonable for this to apply for future PPF increases.

Q2. The Government welcomes comments on the amendments proposed to the draft Compensation Sharing regulations

27. The Government is currently preparing a final draft of The Pension Protection Fund (Pension Compensation Sharing and Attachment on Divorce etc) Regulations 2011 which it intends to lay before Parliament in March with a view to them coming into force in early April. The draft sharing and attachment Regulations' will provide that a former spouse or civil partner of a person who is in receipt of, or is due to receive, pension compensation will be able to receive a share of that compensation.

28. Amongst other things, the sharing and attachment Regulations will set out the manner in which the revaluation amount is to be determined for pension compensation paid to a former spouse or civil partner (the transferee) where the pension compensation comes into payment at a date after the draft sharing and attachment Regulations come into force.

29. The Government has proposed that those regulations will reflect the switch to using the CPI for revaluation purposes when the sharing and attachment Regulations providing for payments to transferees come into force.

30. One respondent commented that revaluation of amounts of compensation paid to a former spouse or civil partner should be based on the member's entitlement to revaluation under the rules of the pension scheme.

31. One pension professional commented that the proposed amendments will result in an equitable outcome for members and their former spouses.

The Government's response

32. It is the Government's view that a former spouse or civil partner (the transferee) should not be entitled to rights that the PPF member (the transferor) would not have been entitled to. Where a transferor's pension compensation rights are being shared on divorce, annulment or dissolution of a civil partnership, it is appropriate for the transferee to be entitled to revaluation based on the same rules that would apply to the transferor's rights to pension compensation.

Q3.The Government welcomes views on the proposed changes to the PPF's section 143 test.

Q4. The Government welcomes views on whether it is appropriate and practical for the actuary undertaking the valuation to decide whether, in practice, the scheme would be likely to able to buy-out protected liabilities on a CPI basis.

33. These two questions are addressed together in this response as they both relate to the same draft provision in respect of the PPF's section 143 test.

34. Valuations undertaken under section 143 of the Pensions Act 2004 are used to determine whether the PPF will assume responsibility for a scheme by assessing whether the scheme's funding position means that it could afford to secure benefits equal to or above PPF compensation levels (calculated in line with relevant legislation) as at the point immediately before the beginning of the PPF assessment period.

35. If a scheme's funding position is found to be sufficient under section 143, the scheme will approach the market to secure benefits for the members. If it cannot find a suitable product to secure benefits above PPF compensation levels, the scheme can apply to the PPF to continue as a closed scheme. If a scheme thinks it has become further under funded since the start of an assessment period, it can apply for reconsideration of entry to the PPF.

36. As part of the consultation on the draft Regulations, the Government proposed to amend provisions under section 143 so that actuaries undertaking section 143 valuations in schemes that entered assessment before the CPI regulations come into force could choose to undertake them on ‘the CPI basis’ rather than an RPI basis where that basis would make a difference to the overall outcome of the valuation (ie. where if assessed on an RPI basis the scheme would be funded below PPF compensation levels; but if on a CPI basis they would be funded above PPF compensation levels).

37. The change was proposed due to the Government’s concern that if a cheaper CPI buy-out market develops, and PPF buy-out assumptions are adjusted by the Board of the PPF, this may lead to a very small number of well funded schemes currently in assessment transferring into the PPF where they may have sufficient funding to obtain pensions for members that are above PPF compensation levels as calculated under the revised provisions.

38. The majority of comments on the section 143 proposals were from pensions professionals. Their feedback acknowledged the good intentions behind the draft provision but identified a number of barriers to its successful operation and some unwanted outcomes.

39. Of particular concern to respondents was the absence of a mature CPI buy-out market to justify a cheaper assumption, and unease at pushing back any cheaper assumption, should it develop, to apply to a period when no such market existed. Some respondents also mentioned that the scheme actuary would not have access to all the relevant information in making this decision.

40. Respondents also indicated that whilst the provision provided relevant schemes with an opportunity to ‘go to the market’, this would not necessarily work in the members’ favour due to further expense such a move incurs and likelihood of schemes being unable to obtain better than PPF level benefits in the open market, and therefore having to re-approach the PPF.

The Government’s response

41. The Government is grateful for the feedback it has received on this complex issue.

42. The Government appreciates respondents’ discomfort with an approach which involves the application of a cheaper CPI basis retrospectively to a point where no such market existed and there is no historical data on which to base such an assumption. It would also wish to avoid placing an unnecessary burden on relevant schemes and the PPF, or create a position where schemes are caught in an indeterminate state between the PPF and insurers. The responses to the consultation have, therefore,

prompted the Government to remove the draft provisions in respect of the section 143 test.

Q12. The Government would also welcome comments on the potential effect of the PPF and the FAS changes on equality between different groups. In particular, the Government welcomes comments on:

- **whether there are any differential impacts on different racial groups;**
- **whether disabled people would be affected differently than non-disabled people; and**
- **whether men and women would be affected differently by these changes.**

43. This question, which sought views on both the FAS and the PPF changes received a number of responses which did not differentiate between the two types of protection. These responses are discussed in Part 1 of the Government's response. However, the Government has provided further analysis of the PPF impacts in the PPF-specific Equality Impact Assessment which has been prepared in respect of these Regulations. The link to the Assessment is provided in the opening section of this document