Department
for Work &
Pensions

Changes to Pension Protection Fund Compensation Regulations

Government Response

September 2018

Introduction

Between 3 July and 24 July 2018, the Department for Work and Pensions consulted on Regulations to clarify that where a person has rights under an occupational pension scheme to a certain type of fixed pension ("a relevant fixed pension") that was derived from service in another scheme, this is to be treated as attributable to pensionable service for the purposes of calculating Pension Protection Fund (PPF) compensation, including the application of the PPF compensation cap.

Relevant fixed pensions are a feature of some individual's occupational pension schemes, which arise by virtue of a transfer payment to the scheme. The initial amount of the pension is determined at the time the transfer payment is received and it is not attributable to a pension credit, or payable as a result of a person's death.

The version of the Regulations which we consulted on in July aimed to remedy the immediate and detrimental impacts of the High Court Judgment in respect of Mr Beaton v the Board of the PPF[1] by ensuring that going forward the PPF could continue to administer the compensation regime as intended.

They sought to do this by ensuring that the PPF could, where applicable:

1. apply the compensation cap and reduction to 90 per cent for those already receiving their pension, who were below normal pension age (NPA) at the assessment date;
2. aggregate benefits for the purpose of applying the cap in relation to deferred and active members below NPA at the assessment date;
3. pay survivor benefits to vulnerable groups such as widows or widowers and eligible dependent children;
4. revalue PPF compensation which is not yet in payment; and
5. apply inflationary increases to compensation payments.

Recent developments

On 6 September[2] the Court of Justice of the European Union (CJEU) handed down its judgment in the case of Mr Hampshire v the Board of the PPF[3], which in summary, concluded that Article 8 of the EU Insolvency Directive requires that an individual's expected old age pension benefits must be protected to a minimum level of 50% in the event of insolvency.

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[1] Anthony Beaton v The Board of the Pension Protection Fund [2017] EWHC 2623 (Ch) (12 October 2017)

[2] CJEU Judgment in Hampshire: http://curia.europa.eu/juris/document/document.jsf?text=&docid=205405&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=737862

[3] The CJEU Judgment in respect of Mr Hampshire centres on whether Article 8 of the EU Insolvency Directive means that scheme members' benefits must be protected to a minimum level of 50% in the event of employer insolvency.

The Government, in conjunction with the PPF, is carefully considering the implications of the Hampshire judgment and will set out its response in due course. However, as the CJEU Judgment on Hampshire also concerns the level of compensation that the PPF is required to pay individuals there will inevitably be an interaction with the PPF compensation cap. In light of this, the Government believes that the best course of action is to amend the final Regulations so that benefits are not aggregated for the purposes of restricting the amount of compensation (the cap) paid to deferred and active members below NPA at the assessment date.

The practical effect of this is that a person's relevant fixed pension will be treated separately from their pensionable service within the scheme, and therefore will be subject to two separate caps. These individuals will receive more PPF compensation than someone whose pension benefits were made up entirely of actual pensionable service. This is not the Government's intention and we had intended to remedy this anomaly as part of this instrument. However, there is a risk that proceeding with this change may result in individuals inadvertently receiving less than 50% of their expected pension benefits within the PPF, which would run counter to the Hampshire judgment. Given the urgent need to protect compensation payments to vulnerable individuals, the Government has decided to proceed to promptly modify the PPF Compensation Regulations 2005 to ensure that the PPF have the legal basis to continue making compensation payments to these groups.

The final Regulations will ensure that the PPF has the legal basis to:

1. pay survivor benefits to vulnerable groups such as widows or widowers and eligible dependent children;
2. revalue PPF compensation which is not yet in payment;
3. apply inflationary increases to compensation payments; and
4. include a relevant fixed pension in the application of the of the 90 per cent level of compensation (subject to the cap) for those already receiving their pension, and who were below NPA at the assessment date.

Once the Government and the PPF have carefully considered the CJEU Judgment, Government will seek to fully remedy the negative effects of the Beaton judgment, to ensure that the PPF compensation regime remains operational and compliant with the requirements in the Insolvency Directive[4]. Depending on final implications this may also include measures to restrict the amount of compensation (the cap) paid to deferred and active members below NPA at the assessment date (consulted on in July)[5].

The consultation

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[4] https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32015R0848

[5] On 23 June 2016, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period, the Government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU.

The Department received a total of 9 responses from a mixture of individuals, trade bodies and pension professionals (see Annex A) and is grateful to all those who responded.

The vast majority of those who responded to the consultation agreed that the Government should legislate to amend the compensation regulations with respect to relevant fixed pensions to ensure that the PPF can administer the compensation regime as the Government intended.

This document sets out the Government’s response to the points raised in response to the consultation.

The consultation responses

The consultation sought views on whether the draft Pension Protection Fund (Compensation) (Amendment) (No.2) Regulations 2018 would restore the policy intention for the PPF, by ensuring that a relevant fixed pension is regarded as attributable pensionable service for the purpose of calculating PPF compensation, including the application of the PPF compensation cap where relevant.

The Government's underlying policy in relation to calculating individual's PPF compensation and the compensation cap did not form part of this consultation, however some respondents provided comments on these areas and the Government has decided to respond to the substantive comments.

The Government is grateful to those respondents who provided comments on the draft Regulations in response to the specific consultation questions, which we have responded to in turn below.

Question 1: Do the Regulations as currently drafted achieve the policy intent as outlined in this consultation document?

Seven of the consultation respondents answered question 1. Six respondents agreed that the proposed Regulations as drafted would achieve the policy intent as outlined in the consultation document. The seventh respondent was unsure the drafted Regulations would completely achieve the policy intent because the draft Regulations would only remedy the situation prospectively i.e. from the date that the Regulations came into force.

Four more respondents also highlighted that the draft Regulations would only restore the policy intent prospectively, and asked whether the Government also intends to bring forward legislation to remedy the problems created by the Beaton judgment for past periods.

Government response

In the consultation document the Government highlighted that primary legislation would be required to fully remedy the problems created by the Beaton judgment. The Government will seek to bring forward this primary legislation at the earliest opportunity to ensure that the PPF compensation regime remains operational and is compliant with the CJEU Judgment in Hampshire[6].

Question 2: Are you aware of any potential unintended consequences for individuals or the PPF resulting from the proposed Regulations?

Seven of the consultation respondents answered question 2. Three respondents felt that the draft Regulations would not result in any unintended consequences.

Two respondents queried how a relevant fixed pension, derived from a transfer, should be treated for the purposes of determining whether that individual was eligible for the

[6] http://curia.europa.eu/juris/liste.jsf?language=en&td=ALL&num=C-17/17

increased compensation cap for long service, and if so how the PPF would ascribe years to the individual's relevant fixed pension.

One respondent questioned whether scheme administrators would always know whether a transfer was a relevant fixed pension transfer and not attributable indirectly or directly to a pension credit.

One respondent also highlighted that there could be other types of pension benefits which may not fall within the definition of pensionable service in Schedule 7 to the Pensions Act 2004[7], and therefore could give rise to similar issues as individuals with a relevant fixed pension.

<u>Government response</u>

Currently, the information provided by the scheme administrators in respect of schemes which enter PPF assessment, should include all relevant data required to calculate the level of payment that scheme members are entitled to. For capped members, this will include data on the periods of the member's pensionable service for all relevant benefits, including benefits derived from a relevant fixed pension. The PPF should therefore hold the information necessary to aggregate these benefits for the purposes of determining whether the member is eligible for the increased cap for long service. Where this information is not available, the PPF can estimate the length of the member's service for the relevant fixed pension. During the PPF assessment period the scheme administrator will also provide the PPF with information on any scheme members who have benefits arising from a pension credit.

The Government considers this as sufficient to ensure that an individual's relevant fixed pension is taken into consideration and can be treated as part of the person's pensionable service when determining whether they are eligible for the increased compensation cap for long service, and that transfers which are derived from a pension credit are not treated as a relevant fixed pension.

These Regulations are only intended to correct the immediate and detrimental implications of the Beaton judgment and to restore the policy intent. We do not consider that it would be appropriate to widen the scope of the Regulations to other types of pension benefits in the way that has been suggested. However, we will keep this matter under review as the changes bed in.

The definition of pensionable service

The consultation document also contained a proposal to delete the 1993 Act[8] definition of "pensionable service" from regulation 1(2) of the Pension Protection Fund (Compensation)

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[7] See paragraph 36(4) of Schedule 7 to the Pensions Act 2004 which provides that:

> Subject to sub-paragraph (5), "pensionable service" means—
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> (a) actual service in any description of employment to which the scheme applies which qualifies the member for benefits under the scheme, and
>
> (b) any notional service allowed in respect of the member under the admissible rules which qualifies the member for such benefits.

[8] See Section 70 of Pension Schemes Act 1993, which provides that;

Regulations 2005. The intended effect is that the definition of pensionable service in paragraph 36 of Schedule 7 to the Pensions Act 2004, as modified by the draft Regulations, will automatically feed through and apply for the purposes of the Compensation Regulations.

Only one respondent commented on this proposal. The respondent welcomed the change, and suggested that we should also take this opportunity to further harmonise the definition of "pensionable service" within PPF regulations by amending the PPF (Multi-employer Schemes) (Modification) Regulations 2005 so that these regulations also use the definition of pensionable service within paragraph 36 of Schedule 7 to the Pensions Act 2004.

Government response

The Government has considered this suggestion and has decided to take this opportunity to amend the PPF (Multi-employer Schemes) (Modification) Regulations 2005 to use the definition of pensionable service in paragraph 36 of Schedule 7 to the Pensions Act 2004.

Other comments

Two respondents queried how PPF would apply revaluation and indexation to a relevant fixed pension. One respondent stated that the changes within draft Regulation 15A(4) would mean that the individual's fixed pension was eligible for revaluation under the original scheme rules, and any statutory revaluation requirements, which could create an issue where the transfer is paid sometime after. Another respondent noted it was unclear how relevant fixed pensions resulting from a transfer will be treated for the purpose of indexation where historical data on the schemes is limited.

One respondent queried how a person with a relevant fixed pension, which had a different normal pension age (NPA) to the rest of their pensionable service would be treated for the purpose of compensation payments.

Government response

When a scheme enters PPF assessment, the scheme rules will continue to apply up to the day before the assessment period begins. After the scheme has entered the PPF assessment period the scheme administrators will continue to administer the scheme, but benefits will be limited to PPF compensation levels in all respects. The relevant PPF rules are that individuals over their scheme NPA will receive 100% of their accrued pension, and those below their scheme's NPA will receive 90% of their accrued pension benefits, subject to an overall cap.

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(2) In this Act, unless the context otherwise requires, "pensionable service", in relation to a scheme and a member of it, means, subject to subsection (3), service in relevant employment which qualifies the member (on the assumption that it continues for the appropriate period) for long service benefit under the scheme.
(3) There shall be taken into account as pensionable service only actual service, that is to say—
(a) service notionally attributable for any purposes of the scheme is not to be regarded as pensionable service; and
(b) no account is to be taken of scheme rules by which a period of service can be treated for any purpose as being longer or shorter than it actually is.

PPF will revalue benefits in line with prices[9] up to a maximum of 5% prior to 6 April 2009 and then to a maximum of 2.5% from the 6 April 2009 onwards, where appropriate. Once in payment, benefits accrued after 6 April 1997 are increased annually in line with inflation (or indexed), subject to a maximum of 2.5%.

During the PPF assessment period all relevant data is gathered from scheme administrators to enable the PPF to calculate how much compensation individuals are eligible for, including where benefits are derived from relevant fixed pension. In addition, the PPF already has the power to determine how much of a member's pensionable service should be treated as having occurred before or from 6 April 1997 where it is not clear.

The NPA of a tranche of compensation derived from a transfer in will depend upon the terms and conditions on which the benefits in the receiving scheme were granted. Typically, where a receiving scheme grants a scheme member added years or a relevant fixed pension within the scheme, this would have the same NPA as any other pensionable service within the receiving scheme. However, if the receiving scheme grants that a member's relevant fixed pension was payable at a different age, without reduction, the PPF would treat these benefits as a separate tranche with its own NPA.

The Government believes that PPF current practices are sufficient to determine the level of compensation an individual is entitled to, and when these payments will become due, but will keep the matter under review as the Regulations bed in.

Additionally, the Government has not been provided with any evidence to suggest that fixed pensions were granted in a receiving scheme at a significantly different time to when the transfer payment was actually received by the scheme. The Government has therefore decided not to make any changes to this provision, but will also keep this matter under review as the Regulations bed in.

Next steps

Subject to normal Parliamentary processes, the final Regulations are scheduled to come into force in early October 2018.

Once published, the regulations will be available on the UK Legislation website.

[9] Revaluation periods on or after 31 March 2011 are calculated using the consumer price index. Periods prior to this are calculated using the retail prices index.

Annex A: Consultation respondents

The Pension Protection Fund

The Society of Pension Professionals

Eversheds Sutherland

Wills Towers Watson

Mercer

The Pensions Management Institute

Independent Trustee Services Ltd

Sacker & Partners LLP

One response from a private individual