Department for Work & Pensions

Draft regulations to allow the Pension Protection Fund to take account of bridging pensions: revised approach

Public consultation

November 2017

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Introduction

This consultation concerns changes to legislation to allow Pension Protection Fund (PPF) compensation to reflect the different rates payable to members in receipt of, or who would have been entitled to receive, a bridging pension under their scheme rules.

Currently, members in receipt of a bridging pension at the higher rate when their scheme enters the PPF receive PPF compensation based on this rate for life. Had the pension scheme not entered the PPF, the member's scheme pension payments would have reduced at State Pension Age (SPA) or at the point stipulated in their pension scheme rules (the decrease date). For some members, this means they may be financially better off in the PPF than they would have been under the rules of their scheme. This was never the intention, so the proposed changes will correct this anomaly, and going forward the compensation that these members receive, in this respect, will more closely reflect the benefits that they would have received in their pension scheme.

Between 31 August and 1 October 2017 the Government ran a consultation – Pension Protection Fund: draft regulations to take account of bridging pensions – which sought views on addressing the PPF bridging pensions anomaly by actuarially converting bridging pensions into a flat-rate, lifetime-equivalent amount (the smoothing approach). The consultation also outlined an alternative approach of moving members to a lower rate of compensation after they reach the decrease date (the scheme rules based approach).

The vast majority of those who responded to the consultation agreed that the Government should legislate to correct the PPF bridging pension anomaly. However, a significant proportion of respondents expressed a preference for the scheme rules based approach. The most common reason given was that the immediate drop in income for pensioners on the high element of their bridging pension could result in personal financial hardship, particularly where the bridge was a high proportion of the member's overall pension.

The Government has carefully considered the responses and has decided to address the PPF bridging pension anomaly by more closely aligning with the approach that schemes would have taken. This will still ensure that the amount of compensation a member receives, in this respect, will not exceed the amount they would have received had their scheme not entered the PPF, whilst addressing concerns around unintended consequences, such as the potential financial hardship that some members might have experienced under the smoothing approach.

Any issues raised in responses to the August consultation which are not addressed by the revised the approach set out in this document will be covered in the Government's response to this consultation.

About this consultation

Who this consultation is aimed at

We expect this consultation to primarily be of interest to those who responded to the previous consultation on this matter. Pension scheme trustees and administrators, members of defined benefit (DB) occupational pension schemes, PPF levy payers and the PPF Board itself may also be interested.

Purpose of the consultation

The purpose of this consultation is to establish whether the draft regulations achieve the policy intent of allowing the PPF to reduce a member's compensation to a lower rate after the member reaches the decrease date. The consultation also seeks views on whether the draft regulations operate as intended, including in the specific circumstances outlined in the consultation document, and whether the regulations give rise to any unintended consequences.

The Government is not consulting on whether regulations should be amended to correct the PPF bridging pensions anomaly. This matter has already been considered and the Government has previously confirmed its intention to legislate.

It is intended that the changes to PPF compensation rules will come into effect, subject to Parliamentary procedures, in February 2018.

Scope of consultation

This consultation applies to England, Wales and Scotland. It is anticipated that Northern Ireland will make corresponding regulations.

Duration of the consultation

The consultation period begins on 17 November 2017 and runs until 23.30 on 3 December 2017.

How to respond to this consultation

Please send your consultation responses to:

PPF and NEST Partnership

Private Pensions and Arm's Length Bodies

First Floor, Caxton House

Tothill Street

London, SW1H 9NA

Email: bridgingpensions.consultation2@dwp.gsi.gov.uk

Government response

We will publish the government response to the consultation on the GOV.UK website. The report will summarise the responses to both this consultation and our earlier consultation.

The consultation principles encourage Departments to publish a response within 12 weeks or provide an explanation why this isn't possible. Where consultation is linked to a statutory instrument responses should be published before or at the same time as the instrument is laid.

How we consult

Consultation principles

This consultation is being conducted in line with the revised Cabinet Office consultation principles published in January 2016. These principles give clear guidance to government departments on conducting consultations.

Feedback on the consultation process

We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator
2nd Floor
Caxton House
Tothill Street
London
SW1H 9NA

Email: caxtonhouse.legislation@dwp.gsi.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information Team:
Email: freedom-of-information-request@dwp.gsi.gov.uk

The Central FoI team cannot advise on specific consultation exercises, only on Freedom of Information issues. Read more information about the Freedom of Information Act.

The Pension Protection Fund

The Pension Protection Fund (PPF) was established by the Pensions Act 2004. It provides compensation to members of defined benefit (DB) occupational pension schemes where the sponsoring employer has suffered a qualifying insolvency event on or after 6 April 2005 and the funds in the scheme are insufficient to buy annuities that would pay pensions at, as a minimum, PPF compensation levels.

The PPF is funded via a combination of transferred scheme funds, recoveries from insolvent employers, investment returns and a levy on eligible schemes.

Following an employer insolvency event, the pension scheme moves into the PPF assessment period. During this time the scheme continues to be run by the scheme trustees, but benefits are limited to PPF compensation rates. The scheme assets are tested against the cost of buying annuities at PPF compensation levels. If a scheme satisfies this test it leaves the PPF assessment period and winds up, as normal. If the scheme does not satisfy this test, the assets and members are transferred to the PPF and compensation is paid.

PPF compensation is paid to those over the scheme's normal pension age (NPA), or those who are in receipt of ill-health or survivors' pension, at the date of the insolvency event at 100 per cent of the pension in payment, or due, at that date. Anyone else is paid compensation that reflects 90 per cent of the accrued pension, subject to an overall cap. From 1 April 2017, the cap at age 65 is £38,505.61 which equates to £34,655.05 when the restriction to 90 per cent is applied. The increased cap for long service was introduced on 6 April 2017 and applies to members who have 21 years or more service in their scheme. For these members the cap is increased by 3 per cent for each full year of pensionable service above 20 years, up to a maximum of double the standard cap.

Bridging pensions

Some DB occupational pension schemes include bridging pensions[1]. Broadly speaking, these allow members of such schemes who retire before reaching SPA to be paid a higher rate of pension until they reach SPA or another date defined in the pension scheme rules (the decrease date). The bridging pension then reduces (or 'steps down') to reflect the fact that the member is now in receipt of their state pension. Effectively, the scheme bridges the gap between the date the member retires and SPA.

The exact date that a scheme member's bridging pension reduces can vary from scheme to scheme and may not always be the date that the member begins to receive their state pension.

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[1] The bridging pension may be one of a range of payment arrangements offered to members taking their benefits or it may be the default or only option.

Pension Protection Fund compensation and bridging pensions

Under current regulations, PPF compensation payments do not take account of any scheduled changes to the member's pension entitlement after the date on which they become entitled to compensation (the assessment date, in the case of members already in receipt of their pension). Therefore, members in receipt of the high rate of a bridging pension on the day before their scheme's PPF assessment period starts currently receive PPF compensation based on this rate for life. Similarly, in those cases where a bridging pension is the default or only pension arrangement offered under the scheme (rather than an option)[2], deferred and active members' PPF compensation would currently be based on the initial, high rate for their lifetime.

Implementation - a scheme rules based approach

The draft regulations amend the Pension Protection Fund (Compensation) Regulations 2005 ("the 2005 Regulations"), and in doing so modify how the PPF compensation provisions in Schedule 7 to the Pensions Act 2004 apply in relation to schemes which include bridging pensions. Following these modifications, PPF will pay the member compensation based on the high rate of bridging pension until the member reaches the decrease date, at which point the amount of compensation will reduce. This will more closely reflect the payment profile under the member's original pension scheme.

For administrative ease and to reduce the risk of error, the bridging element of the member's pension will be treated as a separate tranche of compensation from the member's main lifetime pension element. In the draft regulations, the bridging element is referred to as such and the member's main pension entitlement is referred to as 'the basic element' (see paragraph (2)(a) of regulation 28, to be inserted into the 2005 Regulations by regulation 2(6) of the draft regulations).

The scheme trustees will notify the PPF of the amounts of the basic and bridging elements and the scheme decrease date at the assessment date and these will be fixed by the PPF at that point.

In cases where the decrease date and/or the bridging element cannot be identified from the original scheme rules, the PPF will have discretion to determine an appropriate decrease date and the portion of the bridging pension to be treated as the bridging element. In the draft regulations, the decrease date under the scheme is referred to as the "scheme decrease date", and the date on which PPF compensation

[2] PPF does not offer members options on how to take their compensation so whereas a member may have had a range of options on taking their benefits under the original scheme rules, the PPF will calculate their compensation based on the default or base option.

decreases as the ‘PPF decrease date’ (see inserted regulation 28(2)(a), (3), (4) and (5)).

Indexation

Annual increases will accrue separately on the tranches of compensation relating to the bridging element and the basic element. The increases which relate to the bridging element will cease to be payable once the member reaches the decrease date. After this point the member will only receive compensation payments in relation to the basic element.

The PPF compensation cap

The PPF operates a cap on compensation payments. This affects relatively few people – currently, only 500 PPF members have their compensation capped. New inserted regulation 29(8) of the 2005 Regulations modifies paragraph 26 of Schedule 7 of the Pensions Act 2004 so that, for the purposes of applying the PPF compensation cap to the member’s periodic compensation[3], the value of the bridging element is actuarially reduced so that it takes account of the value across a member’s lifetime, rather than just the initial higher rate. We believe that this is the most straightforward way of handling the compensation cap as it is calculated and deducted just once, at the date on which the member becomes entitled to compensation, rather than recalculated from the decrease date, thus limiting the need for complex calculations and the scope for error.

Should the actuarially reduced rate of the bridging pension (together with the total value of any other benefits to which the member is entitled or has received under the scheme or a connected scheme) be below the cap, their periodic compensation will not be capped, even if this means that initially they receive a rate of compensation which is above the cap. If the total value of their benefits (with the actuarial reduction applied to the bridging pension) is above the cap, then their ‘cap fraction’ (used to calculate their capped rate of compensation) will be adjusted for the purposes of calculating of their periodic compensation to avoid over-capping the member’s periodic compensation across their lifetime. Again, this may mean that some PPF members may initially receive compensation which is slightly above the cap. Given the relatively small numbers likely to be affected[4], we believe that this is justified in the interests of simplicity.

For example:

Two members of the same scheme are entitled to a pension of £35,000 for life but one opts for a bridging pension of £39,000 until reaching age 65 and £34,000 from

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[3] Periodic payments are the regular PPF compensation payments rather than lump sum payments.

[4] Where pension schemes include a bridging element (believed to be only around 10-20% of schemes), evidence to date suggests these tend to be targeted on lower earners who are less likely to be impacted by the compensation cap.

then onwards. Neither has taken a pension commencement lump sum, nor has any other benefit entitlements under the scheme. Assuming that the relevant PPF cap is £32,769.97 (the cap for a member aged 60, which equates to £29,492.97 when the 90% restriction is applied), the member who has not opted for a bridging pension receives PPF compensation of £29,492.97 for life (subject to indexation). The member who has opted to take a bridging pension is receiving a pension of £39,000 when the scheme enters PPF assessment and the PPF determines that, because £5,000 of that pension is only payable for five years, the actuarially reduced total value of their pension for the purposes of applying the cap is £35,000. This exceeds the cap and their compensation is £32,863.60 until they reach age 65, then £28,650.32 from 65 for the remainder of their life.

Survivor benefits

The spouses and civil and relevant partners of members who die after the assessment date but before the decrease date will inherit 50 per cent of the deceased member's compensation in respect of the bridging element, which is then paid until the decrease date.

Where the member dies before reaching their scheme's NPA, the surviving spouse or civil or relevant partner will inherit 50 per cent of the compensation in respect of the bridging element from the date of death and thereafter for the same length of time that the late member would have received compensation in respect of the bridging element. For example, where a married member dies aged 48 on 6 June 2018 and would have received the bridging element for five years from age 60 to age 65, their surviving spouse will receive 50 per cent of the bridging element for five years commencing on 6 June 2018 as well as 50 per cent of the basic element for the remainder of their lifetime.

No surviving dependents other than spouses and civil or relevant partners will inherit the bridge or a proportion of it.

See draft regulation 2(5) and paragraphs (9)-(14) of inserted regulation 29 of the 2005 Regulations.

Commutation

Individuals who are entitled to PPF compensation in respect of a pension which is not yet in payment at the start of the PPF assessment period have the option, when payment commences, to commute a portion of that periodic compensation for a lump sum.

PPF compensation only takes account of the high rate of a bridging pension where either the member is in receipt of that rate when their scheme enters assessment (in which case commutation will not be available), or where a bridging pension would have been the default or only form of pension available to the member under their scheme. Therefore, commutation of compensation in respect of bridging pensions will only be an issue for active and deferred members and postponed pensioners of schemes where a bridging pension was the default or only option.

Following the modifications made by the draft regulations, such members will be able to commute on retirement up to 25% of their total PPF compensation, both in respect of the lifetime and bridging elements. We understand that this does not, of itself, give raise to tax issues but members should obtain advice as necessary with regard to the tax implications for them as an individual.

Early and late retirement

Early retirement, where a member opts to receive PPF compensation before their scheme's NPA, affects deferred and active members only and will therefore be an issue only where the bridging pension was the default or only option under the rules of their original scheme. Such members will have the bridging element (as well as the basic element) subject to an early retirement factor and reduced accordingly.

Late retirement, where a member postpones receipt of their PPF compensation beyond their scheme's NPA, affects deferred and active members and postponed pensioners and, like commutation, will therefore usually only be an issue where the bridging pension was the default or only option under the rules of their original scheme.

Normally, if a member postpones receipt of their scheme benefits they would benefit from an actuarial increase in those benefits from the date they eventually take them. The PPF adopts a similar approach in calculating compensation.

Where a member postpones receipt of their PPF compensation beyond NPA but commences payment before the decrease date, the rate of compensation payable in respect of the bridging element until the decrease date (as well as the compensation payable for life in respect of the basic element) will be actuarially increased to reflect the period of postponement.

However, if the member chooses to postpone receipt of their PPF compensation until after the decrease date, they will lose their entitlement to the bridging element, and PPF compensation received will only be in respect of the basic element. This is in line with the approach that schemes would adopt for individuals who delay taking their bridging pension beyond SPA.

Members will not be permitted to take the bridging and basic elements of their compensation on different dates.

See draft regulation 2(3) and (4) and paragraphs (5)(b), 6(b) and (7) of inserted regulation 29 of the 2005 Regulations.

Consultation questions

1. Do the draft regulations achieve the policy intent as outlined in this consultation document?
2. Are you aware of any unintended consequences resulting from the draft regulations?