Department
for Work &
Pensions

# The Draft Pension Protection Fund (Modification) (Amendment) Regulations 2017

Public consultation

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Publication date: September 2016

# Contents

# Introduction

This consultation concerns the changes needed to secondary legislation to ensure the Pension Protection Fund (PPF) increased compensation cap for long service provided for in the Pensions Act 2014 operates as intended in all situations. Also included with this consultation are the two draft Orders (a commencement order and a transitional provisions order) which are required for the purpose of, or in connection with, the coming into force of the primary legislation. The Government is not consulting on those draft Orders: they are only included to offer the full picture.

# About this consultation

## Who this consultation is aimed at

We would expect this consultation to be primarily of interest to members of the PPF and the Board of the PPF itself. Those working in the private pension field might also have an interest.

## Purpose of the consultation

The main purpose of the consultation is to establish whether the draft Regulations achieve their intended purpose, whether the long service cap operates appropriately in the situations covered by those draft Regulations and that all necessary changes have been identified. In order to understand the context of the proposed changes, this consultation describes how the primary legislation in the Pensions Act 2014 operates. The Government is not, however, consulting on the substance of the primary legislation or when and how this is to be brought into force (for example, the amount of the increase to the compensation cap).

The Government is also seeking views on the two further issues:

- we wish to establish whether the draft Regulations reflect the policy intention and current practice of adding tranches of compensation together only where they are derived from the same source; and
- whether the amount of money purchase rights the PPF can discharge should be increased in line with changes to the tax rules.

## 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 Thursday 15th September 2016 and ends on Wednesday 9th November 2016.

## How to respond to this consultation

Please send your consultation responses to:

Pam Bryson
Pension Protection and Stewardship
1st Floor, Caxton House,
Tothill Street,
London SW1H 9NA

Email:

CAXTONHOUSE.PENSIONPROTECTIONCONSULTATION@DWP.GSI.GOV.UK

## Government response

We will aim to publish the government response to the consultation on the GOV.UK website. 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. The report will summarise the responses and say what the Government intends to do as a consequence.

# 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.

# Background

1. The Pension Protection Fund (PPF) was established by the Pensions Act 2004. It provides compensation to members of defined benefit occupational pension schemes where the sponsoring employer has an insolvency event and the funds in the scheme are insufficient to provide annuities that would pay pensions at, as a minimum, PPF level benefits.
2. Anyone over the scheme's normal pensionable age at the date of the insolvency event is paid compensation that reflects the pension in payment at that date. Anyone else is paid compensation that reflects 90 per cent of the accrued pension, subject to a maximum cap.

## The Compensation Cap

3. The compensation cap limits the amount of compensation paid to an individual in respect of their rights in any scheme that enters the PPF. It is set as at age 65 and actuarially reduced if a person takes their compensation at an earlier age, in order to ensure people who take their compensation at different ages are treated in a similar way. (Paragraph 26 of Schedule 7, Pensions Act 2004)
4. The compensation cap was originally set on 6 April 2005 at £27,777.78 which produced, at age 65, compensation of £25,000 a year (ie. 90 per cent of the cap amount). Since then the cap has been increased annually by the increase in average earnings. However, the cap applied to an individual is the one in place when they first take their compensation. The current (2016/17) compensation cap is £37,420.42 which produces, at age 65, a compensation amount of £33,678.38.

# The Long Service Cap

5. Section 50 of and Schedule 20 to the Pensions Act 2014, once in force, will amend the Pensions Act 2004 to introduce a long service cap. The standard compensation cap is increased by three per cent for each full year of pensionable service above 20 years (ie. 21 years or more) subject to a new maximum of double the standard cap.
6. Any individual who does not have actual pensionable service in relation to all or part of their scheme rights (for example, where a scheme member transferred their rights from a previous scheme and the new scheme offered a specific amount of pension in return for the transfer) will have a length of pensionable service deemed by the PPF (paragraph 9 of Schedule 20).
7. In addition, where the PPF is unable to identify a length of pensionable service for an individual it will be able to deem a length, for the purposes of the long service cap (paragraph 10 of Schedule 20).

## People in receipt of capped compensation when the legislation comes into force

8. Anyone who is entitled to PPF compensation when the legislation comes into force and who has, or is deemed to have, pensionable service of more than 20 full years (ie. 21 years or more) will have their entitlement redetermined. The three per cent uplift will be applied to the cap which *was originally applied to that person's compensation* with effect from the date that the legislation comes into force. (Paragraph 8(2) of Schedule 20 to the Pensions Act 2014.)

9. For example:

   a person became entitled to compensation in July 2005 having been a member of their scheme for 30 years. Their compensation was £25,000 due to having a cap of £27,777.78 applied in their calculation. Their cap will increase to £36,111.11[1] Their new entitlement will be the lower of £32,500[2] or 90 per cent of their original pension amount.

10. Increased entitlement will not be backdated. The increase will begin from the date the legislation is brought into force, which is planned for 6 April 2017.

11. All other elements of the person's entitlement will stay the same. For example if:

    a. the person has had their compensation reduced because they have taken part of their compensation as a lump sum, the same reduction will be applied to their increased amount. No further lump sum will be paid (paragraph 9 of Schedule 20);

    b. the original cap had been actuarially reduced because it was taken before age 65, the same actuarial reduction would be applied to the long service cap (paragraph 12(3) of Schedule 20);

    c. indexation increases have been paid, the amount of the increase will be added back after the new base amount has been determined. (paragraph 8(5) of Schedule 20).

12. Where a person is being paid as a survivor of a person who was entitled to compensation which had been capped (for example, a widow or widower) the survivor's compensation will also be redetermined. The deceased's compensation will be recalculated, as given above, and the survivor's payment redetermined based on that increased amount. (paragraph 10 of Schedule 20)

13. A person who is terminally ill may have been paid their compensation as a lump sum instead of an income. Where this payment occurred within a year of the long service cap legislation coming into force, that lump sum will be redetermined, where appropriate, and any increase due will be paid either to the individual concerned or, where relevant, their estate. (Paragraph 12 of Schedule 20)

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[1] £27,777.78 x 3% x 10 + £27,777.78.
[2] 90% x £36,111.

## Schemes in assessment when the legislation comes into force

14. During the assessment period the scheme assets are tested against the cost of buying annuities covering the scheme's "protected liabilities" (that is providing each member with benefits equal to the compensation which would be paid by the PPF). This scheme valuation will continue to be done on the basis that the long service cap did not exist. (Paragraph 14 of Schedule 20)

15. While a scheme is in the assessment period the trustees continue to have responsibility for paying pensions. However, they are required to limit those pensions to PPF levels of compensation.

16. Going forward, anyone who is being paid a pension that reflects a capped amount of compensation when the legislation comes into force should, if they meet the long service cap conditions, have their pension amount redetermined.

## Schemes winding up when the legislation comes into force

17. Where a scheme which is winding up outside the PPF has a winding up date which is before the date the long service cap legislation comes into force, it should follow the statutory priority order and allocate assets, as if the long service cap did not exist. (Paragraph 15 of Schedule 20)

18. None of these provisions are in force. The intention is that they will come into force on 6 April 2017.

# The Draft Orders

19. The draft Pensions Act 2014 (Commencement No.9) Order 2016 brings:
    a. the amendments made by paragraph 6(3) of Schedule 20 to the Pensions Act 2014 into force on the day after the Order is signed. This is to enable the Secretary of State to make Regulations so as to come into force on 6 April 2017 in relation to the application of the long service cap in cases where tranches of compensation become payable on different dates (see below);
    b. paragraph 22 of Schedule 20 into force at the same time so that the Secretary of State is also able to make transitional provision in relation to the long service cap and pension compensation sharing on divorce in time for 6 April 2017; and
    c. the remaining provisions of the Act relating to the long service cap in section 50 and Schedule 20 into force on 6 April 2017.

20. The Pensions Act 2014 (Pension Protection Fund: increased compensation cap for long service) (Pension Sharing on Divorce) (Transitional Provision) Order 2017 applies the transitional arrangements described above to anyone who is being paid compensation under the Pensions Act 2008. That is where a person is being

paid as a consequence of having been given a share of another person's compensation as part of a financial settlement following a divorce.

21. As already mentioned, the Government is not formally consulting on these two Orders. They are being provided to ensure the reader can see the full picture. However, any comments are nonetheless welcomed.

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## Benefits from more than one source

22. It is possible that a pension scheme member could have a pension entitlement from more than one source or have entitlement which is due at different ages. In these cases the compensation cap is modified.

### *Different sources of entitlement*

23. A person could have entitlement to two different scheme payments. For example, a person could have been a member of the scheme and accrued entitlement on the basis of their own pensionable service and, in addition, have a pension credit entitlement, due to having been married to, or a civil partner of, a member of that scheme. It has always been the intention that, when a person's compensation is calculated, two such entitlements would be kept separate, and separate caps applied. This is, indeed, how the PPF has been calculating compensation entitlement.

24. During the passage of what became the Pensions Act 2014 it was identified that the legislation did not support this calculation method and that it required the two amounts of compensation to be added together and one cap applied. This error was corrected retrospectively in the Act and a power was taken to make any necessary retrospective amendments to secondary legislation, at the same time (see section 51 of the Pensions Act 2014).

25. Draft regulation 2 amends regulation 22(3) of the Pension Protection Fund (Compensation) Regulations 2005 (S.I. 2005/670). Regulation 22 applies where tranches of compensation become payable on different dates. Regulation 2(2) and (3) replaces the current paragraph (6B) with a new one and inserts new paragraphs (6BA) and (6BB). These changes are retrospective and ensure that such compensation arising out of different entitlements are not added together. Benefits are only added together where they are either all attributable to the person's pensionable service or all attributable to a pension credit arising from a divorce or dissolution settlement.

**Question 1:** Do the amendments achieve the result described?

### *Tranches of entitlement*

26. A person could also have a single entitlement, but which is payable at two, or more, different ages. The most common example is where the scheme changed its normal pensionable age from 60 to 65 during a person's pensionable service. In this situation, the PPF pay each tranche as it falls due.

27. Where this occurs the first compensation payment is calculated as if the first tranche of scheme pension is the only pension that exists. When the second tranche is due a "blended" cap is calculated, based on the cap amount applied to the first tranche and the cap amount in place when the second tranche falls due to be paid. This blended cap is calculated by working out the percentage of the cap not used up by the first tranche. Regulation 22 of the Pension Protection Fund (Compensation) Regulations 2005 modifies paragraph 26 of Schedule 7 to the Pensions Act 2004 (the compensation cap paragraph) to achieve this.

28. Draft regulation 2(4) amends regulation 22(3) of the Compensation Regulations to make provision for how pensionable service is to be calculated where tranches of compensation become payable on different dates for the purposes of the long service cap. When in force, paragraph 26A(2) of Schedule 7 to the Pensions Act 2004 (as inserted by Schedule 20 to the Pensions Act 2014) specifies that the amount of the compensation cap depends on the person's age and length of pensionable service when the person **first** becomes entitled to compensation.

29. Draft regulation 2(4) modifies this rule where a person becomes entitled to compensation, having previously become entitled to a tranche of compensation, It enables the pensionable service attached to a second and subsequent tranche to be taken into account for the purposes of calculating a long service cap.

**Question 2:** Do the amendments achieve the result described?

# Lump Sum Discharge

30. Since April 2013 the PPF has been able to pay money purchase funds worth £2,000 or less directly to the member when a scheme transfers into the PPF, if this discharges the member's money purchase entitlement and they are aged 60 or over. This was in line with the conditions then in place for occupational pension schemes under tax legislation.

31. In April 2014, the tax regulations[3] were changed to allow such discharge where the fund is £10,000 or less. The Government is proposing to bring the PPF in line with the new tax maximum.

[3] Regulation 11 of the Registered Pension Schemes (Authorised Payments) Regulations 2009 – SI 2009/1171

32. Regulation 3 amends regulation 9A of the Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006 (S.I. 2006/580) by substituting the figure of £10,000 for the current £2,000.

**Question 3**: Do you think the Government should allow for an increase in the amount the PPF can discharge as a lump sum? Do you think this amendment achieves the end described?

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