



Department
for Work &
Pensions

**CONSULTATION ON THE DRAFT PENSION PROTECTION FUND
(MODIFICATION) (AMENDMENT) REGULATIONS 2017**

The Government Response

March 2017

Introduction

1. On 15th September 2016 the Government published a consultation paper on The Pension Protection Fund (Modification) (Amendment) Regulations 2017. The consultation ran until 9th November 2016 and sought views on whether:
 - a) the draft amendments to the Pension Protection Fund (Compensation) Regulations 2005 achieve the objectives set out in the consultation:
 - i. they ensure that, where a person has two or more entitlements to compensation that arise from different sources, these are not added together before the compensation cap is applied; and
 - ii. they allow for a long service blended cap where entitlement arising from a single source is payable at different dates.
 - b) the Government should increase, from £2,000 to £10,000, the amount of money purchase benefits the Pension Protection Fund can discharge as a lump sum and whether the proposed amendment to the Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006 achieves this outcome.
2. The Government received a total of 22 responses and is grateful to all the respondents listed at Annex A. This document is the Government's response to the consultation.
3. The intention is that the Regulations will be laid before Parliament so as to come into force on 6th April 2017. The changes at 1(a)(ii) above (pension entitlement arising from more than one source) are to be treated as having effect from 6th April 2005. The regulations will be available on the [UK Legislation website](#).

The Consultation Responses

The Long Service Cap

4. The Government did not ask for comments on the policy behind the long service cap, which was settled when the Pensions Act 2014 received Royal Assent. However, a number of responses did address various aspects of the policy and the Government has decided to respond to the more significant comments.

Schemes currently in the process of being considered for entry to the Pension Protection Fund

5. Twelve of the responses, where seven respondents identified themselves as involved with one particular scheme, objected to the way in which schemes in the Pension Protection Fund assessment period when the legislation comes into force deal with the long service cap, where the scheme does not subsequently enter the Pension Protection Fund. Most of these responses focused on the perceived unfairness whereby a member of a scheme that enters the Pension Protection Fund will get the long service cap applied, but a member of a scheme which is slightly better funded, will only get a small increase over and above the standard cap.
6. The legislation dealing with this matter is in the Pensions Act 2014 (see Part 4 Schedule 20) and cannot be changed by regulations. However, because of the level of response, the Government has decided to explain its position in more detail.

Response

7. An eligible pension scheme with an insolvent employer enters an “assessment period” during which the Pension Protection Fund determines whether the scheme will enter the Pension Protection Fund. Part of the assessment process involves the scheme assets being compared against the scheme’s ‘protected liabilities’ - the cost of providing annuities to cover the compensation that the Pension Protection Fund would pay, if the scheme did enter the Pension Protection Fund.
8. During the assessment period the scheme is run by the trustees who continue to pay pensions as they fall due, but the payments must be reduced as necessary so as not to exceed the level of compensation the Pension Protection Fund would pay should the scheme enter the Pension Protection Fund. The scheme trustees are required to increase pension payments made during the assessment period to reflect the introduction of the long service compensation cap, where appropriate.
9. If the funds are sufficient to do so, the scheme leaves the assessment period and winds up as normal, following a statutory priority order. This means allocating to each member sufficient funds to cover the cost of buying an annuity which would provide benefits of at least Pension Protection Fund compensation levels, and then sharing out any funds left proportionately. All entitlement is calculated from the beginning of the assessment period. For example, if a scheme finds it can provide compensation levels plus five per cent, that five per cent is due from the beginning of the assessment period and members are normally paid arrears.

10. When the long service cap legislation was considered by Parliament during the passage of what became the Pensions Act 2014, a decision had to be made as to whether schemes in the assessment period or in the process of winding up when the legislation comes into force should be required to reflect the long service cap. To do so would have meant:

- a) schemes in assessment being required to carry out a further valuation
- b) schemes in wind-up being required to recalculate the asset share for anyone with capped entitlement and re-allocate funds across members.

11. The latter may have required a re-application to the Pension Protection Fund if the number of beneficiaries of the long service cap meant the scheme was no longer funded above Pension Protection Fund compensation levels.

12. It was decided that such schemes would not be required to take account of the long service cap for the purposes of deciding whether the scheme enters the Pension Protection Fund and, as a consequence, would also not be required to take account of the long service cap when winding up.

13. This approach was taken to:

- a) prevent further delays in settling the scheme; and
- b) conserve as much of the funds as possible for the members, given that any new valuation or other extra administration would have to be paid for out of the already reduced scheme funds.

14. It was accepted that a few people might miss out, as the long service cap would not be reflected in their annuity if the scheme did not enter the Pension Protection Fund. This, however, had to be balanced against the advantages of the approach decided upon to the majority of members.

15. As explained previously, this issue was settled in the primary legislation and so cannot be changed by these regulations.

Question 1: Keeping separate compensation arising from different sources

16. Four responses dealt with the drafting of regulation 2(1) to (3). Some respondents commented that the drafting may not clearly achieve the policy intent or that was ambivalent. Suggestions were made to make the operation of the draft regulation clearer. One comment related to whether the provisions, as drafted, were clear as to the position of a person where some of their previous benefits related to pensionable service and some to a pension credit.

Response

17. Having considered the responses, the Regulations have been re-drafted to put the legal position beyond doubt and to make it clear that where a person has accrued pension entitlement on the basis of their own pensionable service and, in addition has a pension credit, the two sources of entitlement are kept separate and separate caps applied when calculating compensation.

Question 2: Dealing with tranches of entitlement from the same source

18. Four responses dealt with the drafting of regulation 2(2)(4). Three thought the original drafting did not clearly reflect the policy intention stated in the consultation paper.

Response

19. Having considered respondents' comments and suggestions concerning the application of the long service cap where a person has two or more tranches of entitlement arising from the same source, the Regulations have now been redrafted to put it beyond doubt that pensionable service is treated cumulatively in relation to the compensation cap.

20. For example, taking a case where a person has two tranches of entitlement, one at age 60 from 15 years pensionable service and one at age 65 from a further 10 years. The standard cap will be applied when calculating entitlement for the first tranche and the long service cap, reflecting 25 years service will be applied when the second tranche comes into payment.

Question 3: Increasing the amount of lump sum discharge

21. Three of the respondents addressed this issue and all welcomed the change. One asked why the amount has been fixed at £10,000 as money purchase benefits can now be withdrawn as an uncrystallised funds pension lump sum.

Response

22. The legislation being amended allows the Pension Protection Fund to make a payment of money purchase benefits as a lump sum where certain conditions are met. This type of lump sum is more analogous to the 'small pots' lump sums which tax rules permit pension schemes to pay, rather than uncrystallised funds pension lump sums. The Government therefore decided to increase the amount of money purchase benefits the Pension Protection Fund can discharge as a

lump sum to £10,000 to align with HMRC changes which raised the £2,000 maximum for equivalent lump sums payable by pension schemes to £10,000.

Annex A

List of Respondents

Association of Consulting Actuaries

Association of Pension Lawyers

Billington, Mr David

Culliford, Mr John

Hargrave, Mr Philip

Izzard, Mr Brian

Linaker, Mr Geoff

Lincoln, Mr Chris

Mercer

Nortel Networks UK Pension Trust Limited

Parker, Mr James

Pensions Action Group

Pensions and Lifetime Savings Association

Regan, Jo

Society of Pension Professionals

Rossiter, Mr Tim

The Pensions Advisory Service

Thomas, Mr Howard

Trades Union Congress

Vine, Mr Peter

Whale, Mr Geoff