These notes refer to the Pensions Act 2011 (c.19)
which received Royal Assent on 3 November 2011

PENSIONS ACT 2011

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 3: Occupational pension schemes

Indexation and revaluation

Section 19: Indexation and revaluation

111. *Section 19* amends four provisions concerning the indexation of defined benefit pensions in payment and the revaluation of the deferred pensions of early leavers from occupational pension schemes following the Government's decision to use the CPI as the measure of increase in the general level of prices in place of RPI.

112. *Subsections (1) to (3)* amend section 84 of the PSA 1993 so that schemes which provide full uncapped revaluation of deferred members' preserved pensions (including GMP rights) may do so without reference to the statutory revaluation requirements contained in section 84 provided they maintain (in the opinion of the Secretary of State) the value of pensions by reference to the rise in the general level of prices in Great Britain.

113. *Subsections (4) to (6)* provide for a new method of calculating revaluation additions by inserting a new paragraph 2A into Schedule 3 to the PSA 1993. The new method is the same as the existing statutory method for final salary schemes, but allows schemes to continue to calculate the revaluation addition as if the annual revaluation order was still calculated by reference to RPI. This means schemes that continue to mirror the statutory revaluation method but use RPI as the inflation measure would not also have to consider the statutory revaluation addition calculated using CPI. This new method is only available where the scheme rules require it.

114. *Subsections (7) and (8)* amend section 51(3) and 51(4) of the PA 1995 to allow schemes to continue increasing pensions in payment under provisions in scheme rules rather than under the statutory requirement contained in section 51(2). In place of increasing by reference to the RPI, schemes will be able to increase by RPI, the CPI or a combination of the two, depending on the rules of the individual scheme. Where schemes continue to increase pensions by RPI and have done so continuously from January 2011 (or when the pension first comes into payment if later), the amendments will ensure they need not carry out an annual comparison of the RPI under scheme rules and CPI under the statutory requirements and pay the higher of the two. This provision continues to apply in situations where members transfer from a scheme that has paid RPI based increases from January 2011 to another scheme that continues to pay RPI based increases.

115. *Subsections (9) to (11)* amend section 40(1) of the WRPA 1999 to allow the Secretary of State to prescribe that (as a minimum) pension credit benefit (arising from a pension share on divorce) paid by an occupational pension scheme must be increased by reference to the percentage increase in the general level of prices determined by the Secretary of State for the purpose of the statutory revaluation requirements.

Section 20: Pension compensation: annual increases in periodic compensation

116. *Section 20* amends Schedule 7 to the PA 2004 and Schedule 5 to the PA 2008. The section removes references to the RPI when calculating indexation increases for pension compensation paid by the PPF. The reference to a specific inflation measure is replaced by a reference to the general level of prices in Great Britain.

117. The section enables the Secretary of State to decide, as the Secretary of State thinks fit, the manner in which percentage increases in the general level of prices are to be determined for this purpose (for example, by reference to CPI) and requires the Secretary of State to publish any such decision. As a result of these amendments, a redundant definition of RPI is omitted from the PA 2004.

Section 21: Indexation requirements for cash balance benefits

118. *Section 21* removes the requirement for cash balance benefits to be indexed under section 51 of the PA 1995.

119. Cash balance benefits are benefits which the member accrues in the form of a lump sum or fund, the level of which can be determined in advance, is guaranteed to reach a particular minimum, or is determined by the application of a notional accrual rate or rate of interest. The fund is then used to buy an annuity or to provide a pension from scheme funds.

120. Current legislation requires that members with cash balance benefits buying or receiving an annuity or being paid a scheme pension must receive Limited Price Indexation. This means that pensions or benefits in relation to accruals between 1997 and 2005 must, once section 19 is brought into force, be indexed to at least the lower of CPI or five per cent and pensions or benefits in relation to accruals post 2005 must be indexed to at least the lower of RPI or 2.5 per cent.

121. Pensions or annuities already in payment prior to this section coming into force will continue to be indexed and will not be affected by the changes in section 21. This section also does not apply to cash balance benefits under any scheme which is or has been contracted-out by virtue of satisfying the requirements of section 9(2) of the PSA 1993 on or after 6 April 1997, for as long as accrued rights or pensions attributable to a period of contracting-out are retained within the scheme.

122. *Section 21* therefore also ensures that the relaxed indexation requirement does apply to schemes which were contracted out on a guaranteed minimum pension basis prior to 6 April 1997. It is not necessary to exclude such schemes from this relaxed requirement, because there are separate indexation requirements for guaranteed minimum pensions.

123. The indexation requirements are not relaxed for career average schemes or schemes which promise a guaranteed rate of conversion of the accrued ‘pot’ to a rate of pension. Section 51ZB(6) ensures that schemes offering pension commencement lump sums or survivors’ benefits of a set percentage of the member’s benefit are not excluded from the definition of cash balance schemes for the purposes of this easement.

Pension Protection Fund

Section 22: Pension Protection Fund

124. *Section 22* gives effect to *Schedule 4*.

Schedule 4: Pension Protection Fund

125. *Paragraphs 1 to 13* make amendments to the PA 2004 permitting the Board of the PPF, where it is able to do so, to determine the funding position of an eligible pension scheme without obtaining a fresh actuarial valuation in accordance with the requirements of

section 143(2) of the PA 2004, which is used by the PPF Board to decide whether it must accept responsibility for the scheme.

126. A scheme's protected liabilities are the cost of providing benefits equivalent to pension compensation, any non-pension liabilities of the scheme, and the estimated cost of winding up the scheme. The amendments provide the PPF Board with the power to decide whether it can use other information for the purpose of determining whether the assets of the scheme are less than the protected liabilities (for example, a valuation undertaken for the purposes of calculating a scheme's pension protection levy), or whether an actuarial valuation is needed to determine the funding position of the scheme.

127. *Paragraph 11* makes equivalent provision in relation to valuations for closed schemes under section 158. Where a scheme has been through an assessment period and has not initially transferred into the PPF, but where the scheme's assets have subsequently fallen below its protected liabilities, the PPF Board will also have the power to determine whether an actuarial valuation under section 158 is required or whether it can use other information it has in order to decide if the scheme should transfer into the PPF.

128. *Paragraph 13* amends Schedule 9 to the PA 2004 (which lists matters that are reviewable by the PPF Board) so that a determination made by the PPF Board, in cases where it has decided that an actuarial valuation is not required, is reviewable.

129. *Paragraphs 14 to 16* remove the requirement in section 151 of the PA 2004 that an application for reconsideration must include a "protected benefits quotation". A protected benefits quotation is a quote, from an insurance company, of the cost of purchasing annuities providing each scheme member with benefits equivalent to the lower of the compensation which they would receive if their scheme transferred to the PPF and their scheme benefits.

130. The amendments secure that the trustees or managers of an eligible scheme that has not initially transferred to the PPF because it was not sufficiently underfunded may apply for reconsideration if the trustees or managers are unable, despite their best efforts, to obtain a protected benefits quotation. The amendments provide the PPF Board with a power to determine whether the value of the assets of the scheme at the reconsideration time is less than the amount of the protected liabilities at that time. If so, the scheme may transfer into the PPF, without the trustees or managers obtaining a protected benefits quotation. The PPF Board will be able to use any information it has available and any additional information it may request in order to determine the value of the assets and liabilities of the scheme at that time.

131. *Paragraph 15* amends section 152 of the PA 2004 to enable the PPF Board to issue a determination notice under that section in a form and containing such information as may be decided by the PPF Board.

132. *Paragraph 17* removes the requirement in section 172 of the PA 2004 that an assessment period for the PPF must last for a minimum of 12 months. An assessment period starts when the employer of a scheme that is eligible for the PPF has a qualifying insolvency event. An assessment period may also start when an employer in relation to a scheme is unlikely to continue as a going concern and the PPF Board receives either an application for transfer from the scheme's trustees or managers under section 129(1) of the PA 2004 or a notification from the Regulator under section 129(4) of the PA 2004. During an assessment period the PPF Board assesses whether or not it must assume responsibility for a scheme. The removal of the requirement in section 172 of the PA 2004 that an assessment period must last for a minimum of 12 months will enable the PPF Board to transfer some schemes into the PPF earlier.

133. *Paragraph 18* removes the requirements in section 316 of the PA 2004 that the statutory instruments listed below must not be made unless a draft of the instrument has been laid before Parliament and approved by a resolution of each House of Parliament. As a

result, those statutory instruments will be subject to the negative resolution procedure. The statutory instruments affected are:

- regulations on the PPF administration levy, which is collected on behalf of the Secretary of State to recoup any money paid by the Secretary of State out of money provided by Parliament to meet the administrative expenses of the PPF Board (section 117 of the PA 2004);
- orders to increase annually the levy ceiling that limits the amount that the PPF Board may estimate it will collect through the pension protection levy (section 178 of the PA 2004); and
- orders to increase annually the pension compensation cap that is applied to compensation paid to people who are below their scheme's normal pension age at the start of an assessment period (paragraph 27 of Schedule 7 to the PA 2004).

134. The levy ceiling and the pension compensation cap are increased annually in line with increases in the general level of earnings. The Secretary of State may also make orders to increase the levy ceiling above the annual increase in line with increases in the general level of earnings and orders to change the pension compensation cap other than because of an annual increase in the general level of earnings. The amendment does not change the requirement that such orders must not be made unless a draft of the instrument has been laid before Parliament and approved by a resolution of each House of Parliament.

135. *Paragraph 19* replaces paragraph 21 of Schedule 7 to the PA 2004 so that the calculation of pension compensation paid to pension credit members includes revaluation, if revaluation would have been applied under the rules of the relevant scheme to the pension credit member's benefits. Under section 83 of the PSA 1993, occupational pension schemes are required to revalue benefits payable by virtue of pension credit rights only where the rights involve the pension credit member being credited by the scheme with notional pensionable service. New paragraph 21 of Schedule 7 deals with the case where the member is not credited with notional pensionable service (so that no revaluation is required). New paragraph 21A deals with the case where the member is credited with notional pensionable service (so that revaluation is required).

136. Under new paragraph 21A, the revaluation would be based on:

- scheme rules for the period from the implementation of a member's pension credit to the day before the start of an assessment period for the PPF; and
- statutory rules for the period from the start of the assessment period to a member's normal benefit age (the equivalent, for pension credit members, to normal pension age).

137. As a consequence, *paragraph 20* repeals paragraphs 10 and 11 of Schedule 8 to the PA 2008.

138. *Paragraphs 21 to 28* replace an existing regulation-making power within paragraph 25A of Schedule 7 to the PA 2004 (as inserted by paragraph 13 of Schedule 8 to the PA 2008) so that people may postpone payment of their pension compensation past their normal pension age.

139. The paragraphs provide that, if a person does postpone payment of pension compensation:

- the pension compensation cap would apply as at the time the person first becomes entitled to pension compensation (their normal pension age);
- revaluation would apply up to a member's normal pension age;

- the PPF Board must provide an appropriate increase in pension compensation when it comes into payment, calculated on an actuarial basis to take account of the postponement of the start of payment; and
- commutation of a portion of the pension compensation to which a person is entitled is possible at the time that postponed compensation comes into payment.

140. *Paragraphs 29 to 36* make amendments parallel to those in paragraphs 21 to 28. These paragraphs omit an existing regulation-making power in paragraph 11 of Schedule 5 to the PA 2008, replacing it with a similar power to prescribe circumstances where a person who is entitled to pension compensation by virtue of pension compensation sharing may choose to receive compensation from a later date than normal benefit age. This power will permit postponement whether or not the person entitled to compensation is below or above normal benefit age at the time that they first become entitled to payment of compensation.

141. *Paragraph 37* amends paragraph 35 of Schedule 7 to the PA 2004. This paragraph requires recent changes to scheme rules which have the effect of increasing the amount of a scheme's protected liabilities to be disregarded in calculating the amount of compensation to which members of the scheme are entitled. Paragraph 35, in conjunction with paragraphs 3(5) and 5(4) of Schedule 7, also stipulate that discretionary increases to pensions that are either in payment or postponed in the three-year period before the start of an assessment period, which have the effect of increasing the protected liabilities, are disregarded.

142. The amendments clarify the operation of these provisions.

Financial assistance scheme

Section 23: Financial assistance scheme: amount of payments

143. *Section 23* amends section 286 of the PA 2004 and section 18 of the PA 2007. These amendments allow regulations to prescribe the circumstances in which the minimum percentages of annual and initial payments specified in those sections do not apply.

144. Currently certain individuals are paid less than the specified minimums where:

- members are in receipt of an ill health payment where, because payments are being made earlier than normal, an actuarial reduction is applied. As a consequence they may get less than the 80 per cent specified in the PA 2004 by way of annual payment and less than the 90 per cent specified in the PA 2007 by way of initial payment; and
- survivors of a polygamous marriage who share the amount payable to a single survivor. As a result each will get less than half the member's payment specified in the PA 2007.

145. This is not intended to allow for changes in the amounts of assistance currently paid to any member of the FAS. It will allow for the FAS Regulations to be made simpler to understand.

Section 24: Financial assistance scheme: transfer of assets

146. *Section 24* amends section 286(3) of the PA 2004 by providing for the property, rights and liabilities of pension schemes that qualify for the FAS to be transferred to a 'prescribed person' rather than 'the scheme manager' as currently stated. It is the intention that the prescribed person will be the Secretary of State.

147. Regulations currently provide for assets to transfer to the Secretary of State by using the FAS Regulations to modify parts of the PA 2004. This change will allow for the FAS Regulations to make it explicit that assets are transferring to the Secretary of State, making the system more transparent.

Miscellaneous

Section 25: Payment of surplus to employer: transitional power to amend scheme

148. *Section 25* amends section 251 of the PA 2004. Section 251 provided trustees with a transitional power to confirm or amend powers in scheme rules to make payments to the employer in the light of changes to the taxation regime for pension schemes, and to the requirements relating to payments of surplus to employers as stated in section 37 of the PA 1995.

149. Section 251 came into force from 6 April 2006. It specifically allowed trustees to pass a resolution to confirm or amend powers in their scheme's rules to make payments to the employer, or allow them to cease to be exercisable. Trustees were required to pass a resolution within five years of the commencement of the provision (before 6 April 2011) and to satisfy prescribed requirements for notifying scheme members.

150. This section ensures that section 251 does not apply to payments which trustees can make without having to satisfy the general requirements relating to payments of surplus in section 37 of the PA 1995. It extends the transitional period during which section 251 will apply to 6 April 2016. This will allow trustees more time to review any powers in their scheme's rules to make payments to the employer, decide how such powers should be exercised in the future, and take whatever action they consider is necessary under section 251.

Section 26: Contribution notices and financial support directions

151. *Section 26* amends sections 38, 43 and 96 of the PA 2004. Section 38 provides the Pensions Regulator with the power to issue a contribution notice where certain conditions are satisfied. Section 43 provides the Pensions Regulator with the power to issue a financial support direction where certain conditions are satisfied. Section 96 describes the standard procedure for consideration of certain of the Pensions Regulator's functions.

152. At present the Regulator must determine to exercise its regulatory functions to issue a contribution notice or a financial support direction within certain statutory periods. The amendments to sections 38 and 43 provide that those periods end with the Regulator giving a warning notice of its intention to exercise its regulatory functions instead of ending with the determination to exercise the relevant regulatory function. The amendment to section 96 also creates a power to prescribe a period after giving a warning notice beyond which the Regulator cannot exercise the relevant regulatory function.

Section 27: Technical amendment to Schedule 4 to the Pensions Act 2007

153. *Section 27* amends a consequential amendment made to Schedule 4 to the PSA 1993 and contained within paragraph 60 of Schedule 4 to the PA 2007.

154. Where an employer becomes bankrupt, the amount of debt (in respect of the contributions owed to a salary-related contracted out pension scheme) is calculated according to the rebate percentages specified in Schedule 4 to the PSA 1993. The consequential amendment as currently drafted would substitute out of date rebate percentages into Schedule 4 to the PSA 1993. This amendment will ensure the most recent rebate percentages are retained in that Schedule.

Section 28: Technical amendment to section 42(6) of the Pension Schemes Act 1993

155. *Section 28* amends an inaccurate cross-reference in section 42(6) of the PSA 1993. A missed consequential amendment, in provisions which amended Schedule 4 to the

PSA 1993 contained within the PA 1995 and the WRPA 1999, means that the power in section 42(6) is unclear.

156. The power specified previously allowed the percentages stated in Schedule 4 to the PSA 1993 (in respect of contributions owed by bankrupt employers of salary-related contracted-out schemes) to be changed in line with changes to the rebate percentages. The amendment will ensure that this power is clear and refers to the correct paragraphs in Schedule 4 which contains the rebate percentages.