EXPLANATORY MEMORANDUM TO THE

PENSION PROTECTION FUND (PAYMENTS TO MEET INVESTMENT COSTS) REGULATIONS 2005

2005 No. 1610

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. **Description**

2.1 The Board of the Pension Protection Fund ("the Board") is established by section 107 of the Pensions Act 2004 (c.35) ("the Act").

2.2 This instrument provides for amounts to be paid or transferred by the Board out of the statutory fund it holds which is known as the Pension Protection Fund ("the Fund").

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None.

4. **Legislative Background**

4.1 The Board is an executive non-departmental public body (NDPB) which, subject to specified conditions, will pay compensation to members of eligible occupational pension schemes where the sponsoring employer is insolvent and the scheme has insufficient assets to pay benefits at a level at least equal to the amount the Pension Protection Fund would provide.

4.2 The Board holds and manages the Fund from which compensation will be paid to the members of schemes for which the Board assumes responsibility. Section 173 of the Act provides for what the Fund shall consist of and for what sums may be paid or transferred out of the Fund.

4.3 These regulations provide for an additional category of payments to be made out of the Fund to allow the costs of investing the assets of the Fund to be met out of Fund.

4.4 Section 113 of the Act enables the Board to invest for the purposes of the prudent management of its financial affairs and further provides that for the purposes of exercising that power the Board must appoint at least two fund

managers. These regulations are intended to allow the costs of employing those fund managers, and of employing custodians, to be met out of the Fund.

4.5 This is the first use of the regulation making power in section 173(3)(k).

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 Not applicable.

7. Policy Background

7.1 The Board has been established as an independent body at arms length from Government with responsibility for its own financial management. However, as an NDPB, the Board will be accountable to its sponsoring Department and to Parliament and is also obliged to adhere to the provisions in the Act governing the Fund it manages. Section 173 has been designed to ensure that income derived from the pension protection levies and assets transferred from schemes which the Board assumes responsibility for are kept separate from any other assets and monies held by the Board and may only be paid out of the Fund for specified purposes.

7.2 The Board has also been given the power to borrow and to invest for the purposes of the prudent management of its financial affairs. These powers are provided for by sections 115 and 113 of the Act respectively. Both of these provisions are intended to provide the Board with greater financial autonomy and to allow for better value for money in managing the Fund. Section 173 further provides that any income from investment or capital gain relating to assets in the Fund must be paid back into the Fund.

7.3 In order to exercise its power to invest the Board is obliged by section 113 to employ at least two fund managers. In this way, the Board must split the management of the Fund in order to manage risk and performance. In practice, it will also be necessary for the Board to employ custodians to implement the management directions of the fund managers.

7.4 Our intention is that the Board should be able to meet the costs of investing the Fund out of the returns on those investments. This is the usual practice in occupational pension schemes. Typically a fund manager may expect to earn a small percentage of the profits they make. That percentage is deducted by

the fund manager before any income is returned to the pension fund. Our intention is for the Board to follow the same practice and for all of the costs associated with appointing fund managers and custodians and with managing the Fund to be met out of the returns on those investments before any income is credited to the Fund. We want to make sure that the costs of managing and investing the Fund are clearly attributable to the Fund itself.

7.5 The legislation as currently drafted makes it clear that any income arising from investing the Fund must be credited back to the Fund. However the provision does not clearly meet the policy intention that this may be net income after investment costs have been deducted. These regulations are therefore being made to give full and clear effect to the policy intention of meeting the costs of investing the Fund out of the returns on those investments.

7.6 It will be noted that from 1st September 2005 the Board will hold and manage a second fund, the Fraud Compensation Fund, from which compensation may be paid to the trustees of managers of most occupational schemes in cases of fraud. The management of this fund is similarly ring-fenced in legislation by section 188. The Board may invest the assets in the Fraud Compensation Fund and must credit the income from any such investment back into that fund. The regulations being made under section 173 do not extend to the Fraud Compensation Fund and we are not seeking to make any parallel provision for that fund. Indeed we are not able to make such provision since there is no appropriate regulation making power. The costs of managing and investing the assets of the Fraud Compensation Fund will therefore be met from the Board's administration funds. This is acceptable in policy terms since the Fraud Compensation Fund will be much smaller than the Pension Protection Fund, with a balance of around £2-3 million. In contrast the Pension Protection Fund will have an annual income of £300 million from the levy alone, so it is much more important for the costs of managing that Fund to be correctly attributed.

7.7 There has been no public consultation on these regulations. It is important that these regulations are brought into force before the Board begins to exercise its power to invest. This has not allowed sufficient time to consult widely. However these regulations have been made in consultation with the Board.

8. Impact

8.1 A Regulatory Impact Assessment has not been produced for this instrument as it has no impact on business, charities or voluntary bodies.

8.2 The impact on the public sector is negligible.

9. **Contact**

9.1 Cathy Twamley at the Department for Work and Pensions tel: 020 7962 8675 or email: cathy.twamley@dwp.gsi.gov.uk can answer any queries regarding this instrument.