EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND (GENERAL AND MISCELLANEOUS AMENDMENTS) REGULATIONS 2006

2006 No.580

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 These Regulations set out a number of technical and procedural requirements for the interaction between occupational pension schemes and the PPF.

2.2 This includes provision for the treatment of liabilities which transfer to the Board at the end of the assessment period, the administration and payment of PPF compensation levels of benefit and exceptions under equal treatment rules.

2.3 The Regulations include provision for the calculation, collection and recovery of the Pension Protection Levy, which the Board of the Pension Protection Fund ("the Board") must impose for each financial year under section 175 (1) (pension protection levies) of the Pensions Act 2004.

2.4 They also provide amendments to existing legislation as a consequence of provisions in the Finance Act 2004 which come into effect on 6th April 2006 and provisions in the Pensions Act 2004 which came into effect in December 2005 but which have no impact on Pension Protection Fund requirements until at least April 2006.

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

3.1 None

4. Legislative Background

4.1 This instrument is the first use of the powers in sections 161, 163, 166, 168, 170,171 and 181 of the Pensions Act 2004. The provisions also apply the powers in sections 126, 151, 179, 315, 318 and paragraph 24 of Schedule 7 to the Act which have already been used to provide the Pension Protection Fund (Entry Rules) Regulations (S.I.2005/590), the Pension Protection Fund (Compensation Provisions) Regulations (S.I. 2005/670) and the Pension Protection Fund (Valuation) Regulations (S.I. 2005/672).

Assumption of Responsibility

4.2 This part uses the powers in sections 161, 163, 166, and 170 of the Pensions Act 2004 and provides for the treatment of contractual liabilities, the treatment and payment of scheme benefits and the discharge of money purchase liabilities which transfer to the Board at the end of the assessment period.

4.3 When contractual responsibilities transfer to the Board, the Board may consider the terms of these contracts and where it is in the interests of members and the Pension Protection Fund it may disapply any onerous terms or substitute reasonable terms or conditions. This could include onerous clauses for increased costs which are activated upon insolvency and would therefore increase a liability that transfers to the Pension Protection Fund.

4.4 Where the Board assumes responsibility for an insurance contract which provides an agreed level of benefit to the trustees in respect of a named member, this responsibility transfers to the Board. The Board would then be responsible for continuing to make payments to the member. The amount specified in the contract may be greater or lesser than the amount of the PPF compensation that the member is entitled to. Provision is therefore made to enable the Board to modify a term or condition of such insurance contracts to enable the payments to be made direct into the Pension Protection Fund. The Board will then provide compensation payments at the appropriate level in accordance with legislative requirements to the member, ensuring equality of compensation provisions for all members.

4.5 Where a member dies before the assessment date and a death in service lump sum payment becomes due under the rules of the scheme but is not paid by the trustees during the assessment period then the Board must make a payment when it assumes responsibility for the scheme. Any payment made by the trustees during the assessment period or when the Board assumes responsibility for the scheme is treated as if it were made before the assessment date and will not impact on any compensation payable to survivors.

4.6 During the assessment period scheme trustees have a responsibility to pay pensions at the PPF levels of compensation. This is due to the fact that if the Board assumes responsibility for the scheme at the end of the assessment period, it does so with effect from the assessment date at the start of the assessment period. The Board must offset payments of pension made to members in the assessment period with the amount of compensation due. If the member has been overpaid pension in the assessment period the Board will recover the amount overpaid including interest from the date the overpayment commences until it is fully recovered. Additionally if the member has been underpaid pension during the assessment period the Board will refund the amount underpaid, including interest. The rate of interest payable is base rate.

4.7 These Regulations give the Board the power to waive recovery of an overpayment where, following representation, the Board considers that recovery will cause hardship. Recovery may also be waived where it is not cost effective to pursue.

4.8 When a hybrid scheme transfers to the PPF at the end of the assessment period all rights, responsibilities and liabilities transfer to the Board. This includes money purchase liabilities due under the scheme rules. The Board has a responsibility to discharge money purchase benefits in full. As this is a pension liability the Regulations require the Board to discharge this liability in a manner similar to a pension scheme. The Board can discharge the liability by purchasing an annuity, making a transfer payment into an appropriate pension scheme, taking out insurance policies or making cash payment if the total pension fund is below the Lifetime Allowance in accordance with HM Revenue and Custom legislation. The member is required to provide details to the Board on the method by which he would like his money purchase benefit to be but if the member fails to provide details within three months of receiving the information from the Board, the Board can discharge its responsibility in the manner it considers the most appropriate.

Equal Treatment

4.9 This part uses the power in section 171 of the Pensions Act 2004 and provides exceptions to the equal treatment of men and women in relation to the payment of compensation when the scheme responsibilities transfer to the Board.

4.10 The Pensions Act 1995 requires that occupational pension scheme rules are modified to remove discrimination and provisions in the Pensions Act 2004 provide that compensation is modified to ensure that there is no discrimination when the Board assumes responsibility for the scheme and pays compensation in accordance with the scheme rules it inherits. In certain circumstances schemes may apply "unequal rules" and powers have been provided to allow the Board to mirror these exceptions. The exceptions include allowing unequal actuarial factors in respect of life expectancy for men and women. In addition if any Regulations are made under the powers in section 64(2) of the Pensions Act 1995, for exceptions to the equal treatment of pension provision for men and women these Regulations may also apply to the Pension Protection Fund.

Administration of Compensation Payments

4.11 This part uses the powers in sections 168(1), (2)(a), (b), (c), (e) and (f) of the Pensions Act 2004. It provides the detail on the administration and payment of PPF compensation payments.

4.12 The Board must make a payment of compensation as soon as is reasonable and practicable following entitlement. The Regulations set out the method for payment of Pension Protection Fund compensation by way of automated credit transfer into a bank or other account held in the name of the person entitled to compensation or joint names with their spouse or civil partner.

4.13 The Board also have the flexibility to alter the method of payment where it considers this is appropriate. This flexibility will enable the Board to pay beneficiaries when, for example, there is a failure with the electronic transfer system or in cases where the Board considers that the beneficiary would suffer hardship.

4.14 Periodic compensation will be paid in instalments of no more than 52 in a year. Where the periodic compensation payment includes a fraction of a penny this will be rounded up to the nearest penny if the fractional amount is 0.5 or more, and rounded down to the nearest penny where the fractional amount is less than 0.5. This method is consistent with industry practice and prevents administrative complexity.

4.15 The Regulations enable the Board to make payments of periodic compensation or lump sum payments to third parties in accordance with a relevant court order or enactment, limited to the amount of the beneficiary's compensation entitlement.

4.16 Where the is a need to recover overpayments to the amount of any excess paid, the overpayment can be recovered in a manner the Board considers appropriate, either in the form of a lump sum or by adjusting future compensation payments. Interest may be charged at base rate beginning when the overpayment was made and ending when the amount is fully recovered.

4.17 The Regulations give the Board the power to waive recovery of an overpayment where, following representation, the Board considers that recovery will cause hardship. Recovery may also be waived where it is not cost effective to pursue.

4.18 Where the Board has determined there has been an underpayment of compensation entitlement it shall refund any shortfall in the manner it considers appropriate and pay interest on the amount underpaid at base rate.

4.19 The Board will suspend payment of compensation where the Board can not make contact with the person entitled to compensation. This could include return of post or suspected fraudulent activity, or where an electronic payment is returned. The Board can resume payment of compensation where it considers those matters to be resolved.

Pension Protection Levy

4.20 Section 181 of the Pensions Act 2004 provides for the calculation, collection and recovery of levies.

4.21 Section 181(5) of the Act specifies that when a scheme is eligible for only part of a year, the amount of levy charged will be apportioned. These Regulations will be the first to make an exception under the prescribing power in 181(5) to provide that schemes which cease to be eligible during the year will be charged the full amount of levy for the year.

4.22 The levy charged to schemes each year relates to information collected by the Board of the Pension Protection Fund or the Pensions Regulator on behalf of the Board, on the position of schemes as at the 31st March each year, and does not take account of changes made to the scheme after this date. These Regulations follow the precedent set by OPRA and The Pensions Regulator by charging schemes for a full year's levy where the scheme becomes ineligible during the year, and continues policy that was in place for 2005/6.

4.23 These Regulations also provide that, where the Board agrees that there are exceptional circumstances, payment of the levy may be made by instalments.

Entry Rules Amendments

4.24 Section 126 of the Pensions Act 2004 provides for the definition of schemes which are eligible for entry into the Pension Protection Fund. Section 151 provides for the scheme to provide additional information for the Board to reconsider entry into the Pension Protection Fund where entry has been disallowed. Powers in these sections have already been used to make the Pension Protection Fund (Entry Rules) Regulations 2005 (S.I.2005/590) ("the Entry Rules Regulations").

4.25 To satisfy the conditions for entry into the Pension Protection Fund an occupational pension scheme must be tax approved in accordance with the requirements contained in sections 590 and 591 of the Income and Corporation Tax Act 1988. These sections are revoked from 6th April 2006 under provisions in the Finance Act 2004 and an occupational pension scheme must satisfy revised conditions in order to be tax registered with HM Revenues and Customs. The references in the Entry Rules Regulations to tax approved schemes are therefore amended to reflect the new requirement to be tax registered.

4.26 Under current legislation, an employee can normally only contribute to one pension scheme at any one time but there is no limit on the amount of pension savings he can accrue over his working life. Provisions in section 111 of the Pension Schemes Act 1993 allow members to make additional contributions to a scheme in order to increase their level of pension in retirement where that scheme has predetermined contribution levels. Provisions in the Finance Act 2004 which come into effect on 6th April 2006 allow individuals to save for pension provision up to their "Lifetime Allowance". As a consequence, there is no requirement for the provision in section 111 of the Pension Schemes Act 1993 and this is repealed by the Pensions Act 2004. Consequentially the reference to voluntary contributions under section 111 is removed from the Entry Rules Regulations.

4.27 At the end of the assessment period if a valuation shows that the scheme has sufficient assets to provide pension at, or above, Pension Protection Fund compensation levels, the Board of the Pension Protection Fund ceases to have involvement with the scheme. The trustees can apply for re-entry into the Pension Protection and must supply additional statutory information and evidence to support the application. This includes details of pension funds which are invested in accordance with the investment principles provided in the Occupational Pension Schemes (Investment) Regulations 1996 (S.I.1996/3127) ("the 1996 Investment Regulations"). The Pensions Act 2004 provides for changes to these investment rules which are reflected in the updated Occupational Pension Schemes (Investment) Regulations 2005 (S.I. 2005/3378) ("the 2005 Investment Regulations") which came into force on 30th December 2005. The reference to regulation 6 of the1996 Investment Regulations has been replaced in the Entry Rules Regulations with the reference to the 2005 Investment Regulations.

4.28 Only those occupational pension schemes which provide defined benefits are eligible for entry into the Pension Protection Fund. Certain schemes including schemes set up under statutory requirements such as public sector schemes are exempt. Regulation 2 of the Entry Rules defines those occupational schemes which are exempt. The provisions are also updated to remove the scheme governed by the Salvation Army Act 1963. This scheme is not considered to fall within the definition of an occupational pension scheme as set out in the Pension Schemes Act 1993 as amended by the Pensions Act 2004 and therefore does not require exempting.

Compensation Provisions Amendments

4.29 This part uses the powers in sections 315(2) and (5) and 318(1) of and paragraph 24(1) and (2) of Schedule 7 to the Pensions Act 2004.

4.30 The purpose of commutation of periodical compensation (compensation payments paid in instalments of no more than 52 in a year) is to enable those members who do not have a right under their pension scheme to a separate lump sum, to give up part of their periodical compensation in return for a tax free lump sum. The Pensions Act 2004 provides that commutation must be undertaken at the time of retirement and is restricted to a maximum of 25% in accordance with HM Revenue and Customs legislation.

4.31 There is no intention to vary the 25% maximum commutation rule, which is available at the time compensation becomes payable. However, the 25% maximum may be exceeded in prescribed circumstances.

4.32 In accordance with HM Revenues and Customs legislation the Pension Protection Fund (Compensation) Regulations 2005 provides that commutation of an individual's entire pension may be taken in cases of triviality (commutation of trivial pensions).Commutation of trivial pensions means if the aggregate of total benefits payable to the employee under all schemes providing benefits in respect of the employment does not exceed the value of a pension of £260 per annum the pensions, including any arising from the payment of Additional Voluntary Contributions (including free standing Additional Voluntary Contributions) may be commuted.

4.33 The triviality limit of £260 per annum pension operates on an employment by employment basis. It looks at the employee's aggregate pension entitlement from the particular employment in question and not all employments.

4.34 HM Revenue and Customs have introduced new legislation, through the Finance Act 2004, to change the rules relating to trivial commutation with effect from 6th April 2006. The new legislation will provide for scheme members to commute up to 1% of their Lifetime Allowance (a ceiling on the amount of tax-relieved pension that an individual may accumulate) between the age of 60 and 75. The Lifetime Allowance is set by HM Revenue and Customs.

4.35 The 1% limit of the Lifetime Allowance takes into account all pensions that the member has under all employers and includes personal pensions. When the member takes trivial commutation, they are required to take all pensions within a 12 month period. The Lifetime Allowance 1% trivial commutation amount relates to 1% of all pension and not just the pensions under the employer or in a connected scheme(s).

4.36 The Lifetime Allowance is set by HM Revenue and Customs at £1.5 million for the year 2006/07 but will increase on an annual basis.

4.37 It is necessary to align compensation rules defined in the Pension Protection Fund (Compensation) Regulations 2005 (SI 2005/670 as amended by SI 2005/993 and 2005/2113) with changes brought about by HM Revenue and Customs on the coming into force of section 214 of the Finance Act 2004.

Valuation Rules Amendments

4.38 This regulation provides for an amendment to the Pension Protection Fund (Valuation) Regulations 2005 to resolve an inconsistency relating to s143 and s179 valuations. This is a technical amendment to ensure the rules regarding section 143 and section 179 valuations work effectively in the valuation of "external liabilities".

5. Extent

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 The Board of the Pension Protection Fund has been established under Part 2 of the Pensions Act 2004 to provide a level of compensation to members of qualifying defined benefit occupational pension schemes and the defined benefit element of hybrid schemes (hybrid schemes include both defined benefit and money purchase elements) where there is an insolvency event and the scheme has insufficient assets to pay pension at least at the Pension Protection Fund compensation levels.

7.2 The Pension Protection Fund is funded through an annual levy charged to all qualifying defined benefit occupational pension schemes. The levy charged to schemes each year relates to information held by the Pensions Regulator on 31st March each year and does not take account of changes made after this date.

7.3 When an employer has an insolvency event, a Pension Protection Fund assessment period is triggered and commences from a day known as the assessment date. During the assessment period the scheme's assets and liabilities are valued to determine whether the Board of the Pension Protection Fund should assume responsibility for the scheme.

7.4 Where it is determined that the scheme has insufficient assets to provide the Pension Protection Fund compensation level of payments all rights, responsibilities and assets of the scheme transfer to the Board of the Pension Protection Fund. The Board then provides compensation in accordance with legislative requirements provided in Schedule 7 of the Pensions Act 2004 and supporting Regulations.

7.5 There is no formal requirement to consult on the majority of these Regulations as the provisions will come into effect within six months of the enactment of the provisions in the Pensions Act 2004. However, to reflect the DWP's commitment to open policy, a public consultation document on all of these Regulations was made available on the DWP website for a period of eight weeks and was also circulated to a range of key organisations.

7.6 The regulations were welcomed. Questions raised were of a technical nature, seeking to clarify terms and concerns on how the Regulations worked in relation to practical situations, such as scheme transfers. The feedback received has not required changes to the Regulations.

7.7 DWP are not required to consult SSAC, as these Regulations have no impact on DWP benefits.

8. Impact

8.1 These Regulations have only a negligible impact on the cost of business, charities or the voluntary sector. Publication of a full Regulatory Impact Assessment is therefore not required.

8.2 There is no impact on the public sector.

9. Contact

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