EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND (MODIFICATION) (AMENDMENT) REGULATIONS 2017

2017 No. 324

1. Introduction

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

2. Purpose of the instrument

2.1 The Regulations principally relate to the introduction in April 2017 of an increased pension compensation cap for long service in the calculation of pension compensation payable by the Pension Protection Fund (PPF). Specifically, the Regulations:

- Allow for any compensation arising from different sources to have two separate caps applied. This amendment is retrospective.
- Provide for the application of the long service cap where a person's entitlement to compensation arises from one source, but at different dates.

2.2 The Regulations additionally allow the PPF to discharge as a lump sum an individual's money purchase benefits where the total value of those benefits is below £10,000.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 Section 51 of the Pensions Act 2014[1] (c.19) ("the 2014 Act") amends paragraph 26 of Schedule 7 to the Pensions Act 2004[2] (c.35) ("the 2004 Act") (pension compensation provisions) with retrospective effect to reflect the long-standing policy and practice that, for the purposes of applying the compensation cap, such benefits should only be 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. Section 51(8) allows for the secondary legislation, which modifies how the compensation cap applies when tranches of compensation become payable at different dates, to be amended with retrospective affect to give effect to this change.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

[1] http://www.legislation.gov.uk/ukpga/2014/19/section/51
[2] http://www.legislation.gov.uk/ukpga/2004/35/schedule/7

4. Legislative Context

The Compensation Cap

4.1 The 2004 Act establishes the Pension Protection Fund (PPF) and Schedule 7 of the Act provides for a cap to be imposed on the amount of compensation payable by the Board where the PPF assumes responsibility for a pension scheme. Section 50[3] of and Schedule 20[4] to the 2014 Act provide for the cap applied to PPF compensation to be increased to recognise long service. This is known as the "long service cap" and it is being commenced with effect from 6th April 2017 by the Pensions Act 2014 (Commencement No 10) Order 2017. These Regulations amend the Pension Protection Fund (Compensation) Regulations 2005 (S.I. 2005/670) ("the PPF (Compensation) Regulations 2005)[5] to ensure that the long service cap operates in line with the policy intent where a member has compensation from more than one source or from one source, but entitlement arises at different dates.

Payment of money purchase benefits as a lump sum

4.2 The Regulations also amend the Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006[6] to increase the maximum value of money purchase benefits that can be paid as a lump sum to £10,000. This reflects changes in the tax rules which apply to equivalent lump sums paid by pension schemes

5. Extent and Territorial Application

5.1 The extent of this instrument is Great Britain.

5.2 The territorial application of this instrument is Great Britain.

5.3 Corresponding provision will be made in Northern Ireland.

6. European Convention on Human Rights

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

7. Policy background

The Compensation Cap

7.1 The PPF provides compensation to members of defined benefit occupational pension schemes where the sponsoring employer has an insolvency event and the scheme assets are insufficient to provide all scheme members with benefits equivalent to the amount of compensation that would be paid by the PPF.

7.2 The compensation payable to anyone who is under their scheme's normal pensionable age at the date of the insolvency (excluding those who have retired on health grounds) is based on 90 per cent of their accrued pension. This amount is subject to an overall maximum (the compensation cap). While this cap operates as intended, it can have a

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[3] http://www.legislation.gov.uk/ukpga/2014/19/section/50
[4] http://www.legislation.gov.uk/ukpga/2014/19/schedule/20
[5] http://www.legislation.gov.uk/uksi/2005/670/made
[6] http://www.legislation.gov.uk/uksi/2006/580/regulation/9A

disproportionate effect on those with long service in a single scheme, see the Impact Assessment[7] prepared for the 2014 Act.

7.3 This is being remedied by the long service cap which increases the standard cap by 3 per cent for every complete year of pensionable service above 20 years, up to a new maximum of twice the standard cap.

7.4 The Pension Protection Fund (Compensation) Regulations 2005 already modify the application of the cap where compensation becomes payable on different dates. Those Regulations require amendment so that the long service cap operates as intended in these circumstances. Where a person has two payments of compensation arising from different sources, for example based on their own pensionable service and as a widow of a deceased scheme member, the Regulations provide for such benefits to be treated separately and two separate caps applied, in line with the existing policy intent and practice. They also ensure that a person's pensionable service is treated cumulatively so that those with tranches of compensation payable from the same source at different dates can benefit from the long service cap.

Payment of money purchase benefits as a lump sum

7.5 The 2004 Act and regulations made under it specify the manner in which money purchase benefits which transfer to the Pension Protection Fund (PPF) may be discharged. The benefits may be paid as a lump sum if certain conditions are met.

7.6 The PPF does not provide any compensation in relation to money purchase benefits. In general, any scheme with such benefits discharges them before the scheme transfers to the PPF. However, there are occasions when the scheme is unable to do so, (for example where Additional Voluntary Contributions were part of a defined benefit scheme) and those benefits are transferred to the PPF.

7.7 The PPF holds this money and is required to inform all members with money purchase benefits of their options, within three months of the scheme transferring into the PPF. Specifically, if the benefits are below £2,000 and the member is over normal minimal pension age (currently 55) or meets the "ill-health" condition under tax legislation, the benefits may be paid as a lump sum, in line with the tax rules governing pension schemes.

7.8 In April 2014 HMRC raised the £2,000 maximum for equivalent lump sums payable by pension schemes to £10,000. These Regulations amend the PPF legislation to bring it into line with the tax maximum.

Consolidation

7.9 Informal consolidated text of instruments is available to the public free of charge via:

www.legislation.gov.uk.

8. Consultation outcome

8.1 A public consultation on the draft regulations ran from 15th September 2016 to 9th November 2016 and 22 responses were received.

[7] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/210728/pension-protection-fund-compensation-cap-amendments.pdf

8.2 Five of the responses made comments on the technical drafting of the regulations. Comments received included suggesting that the regulations could be drafted differently to more clearly reflect the policy intent. Amendments have been made to the drafts in light of these comments.

8.3 While comments on the underlying policy concerning the long service cap were not requested as that had been settled as part of the passage of the 2014 Act, 17 responses mentioned various aspects of the policy. In particular, the issue of the treatment of schemes in the PPF assessment period when the legislation comes into force attracted 12 responses.

8.4 In view of the relatively high number of comments on this issue, the Government has responded fully in its consultation response. In brief, it was decided at the time of the passage of the 2014 Act that to require schemes in the assessment period, or those in the process of winding up, to reflect the long service cap from April 2017 would have caused further delays in the Pension Protection Fund (PPF) assessment and imposed additional costs on the affected schemes which would have been disproportionate, given the relatively few members affected.

8.5 The Government's response to the public consultation has been published and can be found at: https://www.gov.uk/government/consultations/the-draft-pension-protection-fund-modification-amendment-regulations-2017.

9. Guidance

9.1 The PPF has already informed those members who will see an uplift in their compensation as the result of the changes to the cap in respect of long service. Members who are due to retire shortly after 6 April will be informed of the changes in their quotation letters. For the membership at large, the changes will feature in the March edition of the PPF member newsletter with general letters and the PPF website being updated as soon afterwards as possible.

10. Impact

10.1 There is no impact on business, charities or voluntary bodies.

10.2 The introduction of the increased compensation cap for long service gives rise to administrative costs for the PPF of altering systems, processes and communications, which are estimated to be a one-off £500,000 - £700,000.

10.3 An Impact Assessment has not been prepared for this instrument as the changes are technical to ensure that the long service cap operates as intended.

11. Regulating small business

11.1 This legislation does not apply to the activities that are undertaken by small businesses.

12. Monitoring & review

12.1 The PPF publishes an Annual Report which covers its performance over the previous year. In addition, it has regular meetings with Department for Work and Pensions officials to review its work and the progress in implementing the long service cap will be included in these reviews.

13. Contact

13.1 Jill Metcalfe at the Department for Work and Pensions telephone: 0113 232 4450 or email: Jill.Metcalfe@dwp.gsi.gov.uk can answer any queries regarding the instruments.