EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND (PENSION COMPENSATION CAP) ORDER 2007

2007 No. 989

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 This Order sets out the level of the compensation cap for the Pension Protection Fund (PPF) from 1st April 2007 as a result of a review by the Secretary of State in the 2005/2006 tax year of the general level of earnings.

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

3.1 None.

4. Legislative Background

4.1 Paragraph 26(7) of Schedule 7 to the Pensions Act 2004 is relied upon to make an Order to specify the amount of the compensation cap.

4.2 Paragraph 27(2) of Schedule 7 to the Pensions Act 2004 provides that the Secretary of State must make an Order to increase the amount of the compensation cap if, on a review under section 148(2) of the Social Security Administration Act 1992, the Secretary of State concludes that the general level of earnings obtaining in Great Britain exceeds the general level at the end of the period taken into account for the last review under that section.

4.3 Paragraph 27(3) of Schedule 7 to the Pensions Act 2004 requires the Order to provide that the increase is to have effect from 1st April next following the end of the tax year to which the review relates.

4.4 The Secretary of State reviewed in the 2005/2006 tax year the general level of earnings in Great Britain and concluded that the general level exceeded by 3.4 per cent the general level at the end of the period taken into account for the last review under section 148(2) of the Social Security Administration Act 1992.

4.5 The provision of a compensation cap is one of a number of measures introduced to limit the level of expenditure of the PPF against the level of income generated by way of the levies charged to eligible schemes.

4.6 The level of the compensation cap has been set to encourage scheme members, in particular those with high earnings, to become more involved in scheme matters and help reduce the risk of the scheme entering the PPF.

4.7 To achieve this, the level of compensation payable by the Board of the PPF (the Board) to members who are below their scheme's normal pension age is limited to a maximum of 90 per cent of the compensation cap.

4.8 The current compensation cap is £28,944.45. In calculating a member's compensation entitlement the cap is applied before compensation is reduced to the 90 per cent level. This provides that the total value of compensation payments for members below normal pension age does not exceed £26,050.01 per year at age 65. This amount is adjusted depending on age to ensure that the actuarial value of the compensation package remains the same.

4.9 Average earnings, as measured by the Average Earnings Index and published by the Office of National Statistics, increased by 3.4 per cent in the 2005/2006 tax year. If that percentage is applied to the current compensation cap this will provide an uprated cap of £29,928.56. When applying the 90 per cent provision to that uprated cap it would provide, at age 65, a maximum level of compensation of £26,935.70.

4.10 Article 2 of this Order specifies that the compensation cap shall be £29,928.56 from 1st April 2007.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

James Purnell, Minister of State for Pensions Reform has made the following statement regarding Human Rights:

In my view the provisions of the Pension Protection Fund (Pension Compensation Cap) Order 2007 are compatible with the Convention rights.

7. Policy background

7.1 The Pensions Act 2004 established the PPF, a statutory body run by the Board, which became operational on 6th April 2005. The PPF was set up to provide compensation to members of eligible defined benefit occupational pension schemes, where the employer has a qualifying insolvency event, there is no possibility of a scheme rescue and there are insufficient assets in the scheme to pay benefits at PPF compensation levels.

7.2 The PPF will provide two levels of compensation:

- for individuals who have reached their scheme's normal pension age or, irrespective of age, are either already in receipt of a survivors' pension or a pension on the grounds of ill health, the PPF will pay 100 per cent level of compensation, subject to PPF rules; and
- for the majority of people below their scheme's normal pension age, the PPF will pay 90 per cent level of compensation subject to the compensation cap and PPF rules.

7.3 PPF compensation is funded in two ways – by means of levies charged to all eligible occupational pension schemes and by assets remaining in schemes which transfer to the PPF at the end of an assessment period. The levies incorporate a risk-based element.

7.4 Where an insolvency event occurs the scheme enters an assessment period during which time the trustees or managers are required to provide payment to members at the lower of PPF compensation levels and scheme benefit levels.

7.5 At the end of that assessment period if a valuation shows that the scheme has assets below the level required to provide pensions at least equal to PPF compensation payments and a scheme rescue is not possible the Board assumes responsibility for the scheme.

7.6 All assets and liabilities of the scheme transfer to the PPF and the trustees or managers are discharged of their responsibilities towards the scheme.

7.7 The Board is then responsible for providing compensation payments out of the PPF, to the members of those schemes which have transferred in, in accordance with the compensation provisions.

Consultation

7.8 There is no statutory requirement upon the Secretary of State to consult before he makes an Order under the Pensions Act 2004.

Guidance

7.9 Guidance on this Order will be put on the DWP website “What’s New” section when it comes into force. The PPF will also have copies of the instrument and be in a position to explain the provisions to members of the public.

Consolidation

7.10 The compensation cap is uprated annually by affirmative Order in line with the general level of earnings obtaining in Great Britain. Consolidation is therefore not appropriate in this instance.

8. Impact

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

8.2 There is no impact on the public sector.

9. Contact

Nick Skates at the Department for Work and Pensions Tel: 020 7962 8872 or e-mail: Nick.Skates@dwp.gsi.gov.uk can answer any queries regarding the instrument.