EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND (PENSION COMPENSATION CAP) ORDER 2010 [DRAFT]

THE OCCUPATIONAL PENSION SCHEMES (LEVY CEILING – EARNINGS PERCENTAGE INCREASE) ORDER 2010

2010 No. 1

AND

THE OCCUPATIONAL PENSION SCHEMES (LEVY CEILING) ORDER 2010 [DRAFT]

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 instruments

2.1 These three Orders are made each year to increase two amounts used for the Pension Protection Fund (PPF). The increases ensure that inflation is taken into account in the value of these two amounts. The two amounts are:

- the compensation cap, which controls PPF expenditure by limiting the amount of compensation payable by the PPF, and
- the levy ceiling, which controls the maximum amount of levy the PPF can charge pension schemes.

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

3.1 None

4. Legislative Context

4.1 Compensation Cap Order
This Order sets out the level of the compensation cap for the PPF from 1st April 2010 as a result of a review by the Secretary of State of the general level of earnings in the 2008/2009 tax year.

4.2 The Secretary of State is required to make an Order to increase the amount of the compensation cap. This requirement arises where she concludes that the general level of earnings in Great Britain has gone up over a set period of time (see section 148(2) of the Social Security Administration Act 1992).

4.3 The Secretary of State has reviewed the general level of earnings in Great Britain for the purposes of determining the amount of the compensation cap. She concluded that the general level of earnings for the period from April 2008 to April 2009 (i.e. the 2008/09 tax year) exceeded the general level of earnings at the end of the period taken into account for the last such review by 3.5 per cent. The period for the last such review, for the purposes of the current Compensation Cap Order (S.I. 2009/795), was the 2007/2008 tax year.

4.4 The level of compensation payable by the Board of the PPF to members who are below their scheme's normal pension age is normally limited to a maximum of 90 per cent of the compensation cap.

4.5 Average earnings, as measured by the Average Earnings Index and published by the Office of National Statistics, increased by 3.5 per cent in the 2008/2009 tax year. That percentage is applied to the current compensation cap, which provides an uprated cap of £33,054.09. When applying the 90 per cent provision to that uprated cap it will provide, at age 65, a maximum level of compensation of £29,748.68.

4.6 Levy Ceiling (Earnings - Percentage Increase) Order
This Order specifies the increase in the general level of earnings for the year ending on 31st July 2009, for the purposes of uprating the levy ceiling for the financial year beginning on 1st April 2010.

4.7 Levy Ceiling Order
This Order specifies the amount of the levy ceiling for the financial year beginning on 1st April 2010. It does so by reference to the increase in the general level of earnings specified under the Occupational Pension Schemes Levy Ceiling (Earnings - Percentage Increase) Order.

4.8 The Board of the PPF is required to charge a levy to defined benefit occupational pension schemes (and the defined benefit element of hybrid schemes) to fund the compensation it will pay to schemes' members if their employer becomes insolvent and the scheme is underfunded below a certain level.

4.9 The Secretary of State is required to set a levy ceiling, preventing the PPF from raising the levy above a set maximum. The current ceiling of £863,412,967 came into effect on 1st April 2009 (S.I. 2009/794).

4.10 The ceiling is uprated annually in line with the general level of earnings in Great Britain (unless there is no increase in the general level of earnings). The Secretary of State reviewed the general level of earnings and concluded that earnings in Great Britain had risen by 0.9 per cent during the year from 1st August 2008 to 31st July 2009. The Secretary of State is therefore required to prescribe that percentage in the Occupational Pension Schemes (Levy Ceiling – Earnings Percentage Increase) Order 2010.

4.11 The 0.9 per cent figure was obtained from the Office of National Statistics, is not seasonally adjusted and does include bonuses. This is to maintain consistency with the types of figures used to uprate the PPF compensation cap.

4.12 The ceiling is uprated in line with earnings as this is the closest approximation to the increase in a scheme's liabilities where compensation payable is linked to a member's earnings.

4.13 The Levy Ceiling Order specifies the levy ceiling figure to be imposed on the pension protection levy for the financial year beginning on 1st April 2010 as £871,183,684.

5. Territorial Extent and Application

5.1 These instruments apply to Great Britain.

6. European Convention on Human Rights

6.1 The Minister of State for Pensions and the Ageing Society, Angela Eagle, has made the following statement regarding Human Rights:

In my view the provisions of the Pension Protection Fund (Compensation Cap) Order and the Occupational Pension Schemes (Levy Ceiling) Order are compatible with the Convention rights.

6.2 As the Occupational Pension Schemes (Levy Ceiling - Earnings Percentage Increase) Order 2010 is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 The Pensions Act 2004 established the PPF, a statutory fund run by the Board of the PPF, who are a corporate body, from 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. An insolvency event is typically when an employer does not have sufficient funds to pay its debts, buy goods, etc.

7.2 The PPF provides 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 survivor's pension or a pension on the grounds of ill health, the PPF will pay a 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 a 90 per cent level of compensation subject to the compensation cap and PPF rules.

7.3 The compensation cap is a limit on the compensation that can be paid by the PPF to a single member who is under the normal pension age of the scheme at the assessment date and who is not in receipt of a survivor's or admissible ill-health pension. The compensation cap is one of a number of measures which helps to control PPF expenditure to enable sustainability of the PPF. It encourages high earners, who have influence over the scheme, to ensure the scheme does not enter the PPF. This is achieved by limiting compensation to a level of 90 per cent and applying the compensation cap, for the majority of members under normal pension age. (The assessment date is the start of the PPF assessment period.)

7.4 PPF compensation is funded in three ways – by means of compulsory levies charged to all eligible defined benefit occupational pension schemes, by assets remaining in schemes which transfer to the PPF at the end of an assessment period, and by the investment returns from each of these. The levies incorporate a risk-based element.

7.5 The levy ceiling is one of two statutory controls that prevents the Board of the PPF from raising the pension protection levy above a certain amount. The ceiling is set at a level that is sufficient to allow the Board of the PPF to raise a levy that ensures the safe funding of the compensation it provides, whilst providing reassurance to business that the levy will not be above a certain amount in any one year.

Consolidation

7.6 The compensation cap and the levy ceiling are uprated annually by affirmative Orders in line with the general level of earnings in Great Britain. Consolidation is therefore not appropriate in these instances.

7.7 The Occupational Pension Schemes Levy Ceiling (Earnings - Percentage Increase) Order does not amend any previous instruments, although it is related in part to the Occupational Pension Schemes (Levy Ceiling) Order. Consolidation is therefore not appropriate in this instance.

8. Consultation outcome

8.1 Consultation was not carried out on a draft of these Orders, as there is no statutory requirement upon the Secretary of State to consult before she makes these types of Order. The Orders do not change policy, the Orders are routine and for annual uprating purposes and there is no scope to change the Orders as a result of consultation. Therefore, whilst consultation was considered it was not conducted for these reasons.

9. Guidance

9.1 No guidance is being issued on these instruments since they are largely based on existing legislation. The DWP will have copies of the instruments and be in a position to explain them to members of the public.

10. Impact

10.1 These Orders amend the existing regulatory regime by a pre-determined formula and have no direct impact on the private or voluntary sectors.

10.2 These Orders have only a negligible impact on the public sector.

10.3 A full impact assessment has not been prepared for these instruments.

11. Regulating small businesses

11.1 This legislation does not apply to small business.

12. Monitoring & review

12.1 These Orders are the annual upratings in the levy ceiling and the compensation cap using increases in the general level of earnings in Great Britain. They are all monitored by the DWP and the PPF and reviewed every 12 months.

13. Contact

Any queries regarding these instruments are to be directed to John Isaac at the Department for Work and Pensions Tel: 020 7449 7419 or e-mail: John.isaac@dwp.gsi.gov.uk