EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND AND OCCUPATIONAL PENSION SCHEMES (LEVY CEILING AND COMPENSATION CAP) ORDER 2019

2019 No. 159

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 Pension Protection Fund (PPF) provides compensation to pension scheme members whose employer has become insolvent and cannot meet scheme liabilities; it is funded mainly by a levy collected from pension schemes. This instrument increases two amounts used by the Board of the Pension Protection Fund (the Board). The increases ensure that rises in average earnings are taken into account in setting these two amounts so that they maintain their value. The two amounts are:

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

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

4.1 The extent of this instrument is Great Britain.

4.2 The territorial application of this instrument is Great Britain.

4.3 The Department for Communities in Northern Ireland will be introducing its own legislation replicating this Order for Northern Ireland.

5. European Convention on Human Rights

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

6. Legislative Context

6.1 This instrument sets out the new levy ceiling and the level of the standard amount of the compensation cap for the PPF from 1 April 2019.

6.2 The Secretary of State is required to uprate the levy ceiling annually (section 178(1) of the Pensions Act 2004)[1] in line with the general level of earnings in Great Britain, unless there is no increase in the general level of earnings in the review period. Section 178(4) of the Pensions Act 2004 and regulation 3 of the Pension Protection Fund (Levy Ceiling) Regulations 2006[2] provide that the review period is the period of 12 months ending on 31st July each year.

6.3 The Secretary of State is also required to make an Order under paragraph 26A(7) of Schedule 7 to the Pensions Act 2004 to specify the standard amount of the compensation cap for the purposes of paragraph 26A(3) and (4) of that Schedule. Article 4 of the Pension Protection Fund and Occupational Pension Schemes (Levy Ceiling and Compensation Cap) Order 2018[3] (the 2018 Order) specifies the current standard amount at which compensation is capped.

6.4 Paragraph 27(2) of Schedule 7 to the Pensions Act 2004 requires the Secretary of State to make an Order increasing the amount specified for the purposes of paragraph 26A(7) where she concludes on a review under section 148(2) of the Social Security Administration Act 1992[4] that the general level of earnings in Great Britain has gone up over the period of a tax year. That requirement applies in relation to the amount specified by Article 4 of the 2018 Order.

6.5 The Court of Justice of the European Union (CJEU) handed down its judgment in the case of Grenville Hampshire (C-17/17) (the Hampshire judgment) on 6 September 2018[5]. In summary, the CJEU concluded that Article 8 of the Insolvency Directive 2008/94/EC requires that an individual's expected old age benefits must be protected to a minimum level of 50 per cent in the event of insolvency and that a person's compensation must not fall below this 50 per cent minimum.

6.6 The new compensation cap would only apply to members entering the PPF in the year in question. Capped members entering that year would benefit from a higher compensation cap, but for a small minority, this could still be less than the 50 per cent of their expected old-age benefits required by the Hampshire judgment[6].

6.7 However, if the order were not made, all newly capped PPF members would be worse off, including members who are not affected by the Hampshire judgment, as they would be subject to the 2018 compensation cap amount which does not take into account the recent increase in earnings.

6.8 The Government has carefully considered the implications of the Hampshire judgment and intends to legislate at the earliest opportunity to ensure that compensation received from the PPF does not equate to less than 50 per cent of the member's expected old-age benefits as required by the Hampshire judgment.

[1] https://www.legislation.gov.uk/ukpga/2004/35/contents
[2] http://www.legislation.gov.uk/uksi/2006/2692/made
[3] http://www.legislation.gov.uk/uksi/2018/39/contents/made
[4] http://www.legislation.gov.uk/ukpga/1992/5/contents/enacted
[5] https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1546435250705&uri=CELEX:62017CA0017
[6] The compensation of existing capped members is already subject to annual indexation increases administered by the PPF under paragraph 28 of Schedule 7 to the Pensions Act 2004.

6.9 However as the Hampshire judgment has direct effect on the PPF, it has written out to affected individuals to gather further information on their original pension and expects to shortly begin making payments so that affected individuals receive at least 50 per cent of their expected old-age benefits[7].

7. Policy background

What is being done and why?

7.1 The PPF provides 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 pension benefits at least at PPF compensation levels.

7.2 The PPF provides two levels of compensation:

- for members 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 Board will pay compensation at 100 per cent of the pension due at the assessment date (date at the start of the procedure by which the Board assesses whether the scheme can enter the PPF)
- for members below their scheme's normal pension age, the Board will pay compensation at 90 per cent of the pension accrued at the assessment date, subject to an overall cap.

7.3 The PPF is funded by:

- the pension protection levy that is charged to eligible defined benefit occupational pension schemes
- the remaining assets of schemes that enter the PPF
- funds recovered from insolvent employers
- investment returns on the PPF's assets.

7.4 The pension protection levy consists of a risk-based levy that is required by law to be at least 80 per cent of the total, with a scheme-based levy making up the remainder. The scheme-based levy is calculated using the level of a scheme's liabilities. The risk-based levy is calculated using the level of a scheme's underfunding and the likelihood of employer insolvency for that scheme.

7.5 Each year the Board is required to estimate the total amount of the pension protection levy it will collect. The levy ceiling prevents the Board from imposing a total levy in excess of the amount specified by this instrument. The ceiling is set at a level that is sufficient to allow the Board to raise a levy that ensures the safe funding of the compensation it provides, whilst providing reassurance to schemes that the levy estimate will not be above a certain amount in any one year.

7.6 This instrument specifies that the increase in the general level of earnings for the year ending on 31 July 2018 is 3.3 per cent over the previous year. Therefore, the amount of the levy ceiling for the financial year beginning on 1 April 2019 is £1,058,176,617. The new levy ceiling has been calculated by increasing the current levy ceiling (£1,024,372,330) by this 3.3 per cent.

[7] https://www.ppf.co.uk/news/update-european-court-justice-ruling

7.7 The compensation cap limits the compensation that can be paid by the Board to a single member under the normal pension age of the scheme at the assessment date and who is not in a receipt of a survivor's or admissible ill health pension. The standard amount of the compensation cap is set by the Secretary of State and compensation to affected members will normally be limited to a maximum of 90 per cent of the cap.

7.8 The cap is intended to limit costs in the PPF and to deter excessive risk taking and malpractice by, for example company directors, whereby decisions could be taken that result in the insolvency of the company, in the knowledge that their pension benefits and those in respect of their colleagues would in effect be insured by the PPF. This is a common feature of insurance and financial compensation or assistance schemes.

7.9 On 6 April 2017 the increased cap for long service[8] was introduced within the PPF. The standard amount of the cap is increased by 3 per cent for each full year of pensionable service over 20 years, subject to a new maximum of double the standard amount of the PPF compensation cap. This is to ensure that individuals with long service within a single scheme are not disproportionately affected by the compensation cap.

7.10 The Secretary of State is required to make an Order to set out the standard amount of the cap. Where the Secretary of State concludes that the general level of earnings in Great Britain has gone up over the period of a tax year (on a review under section 148(2) of the Social Security Administration Act 1992) she is required to make an order to increase the standard amount by that earnings percentage increase.

7.11 The Secretary of State has reviewed the general level of earnings in Great Britain. She concluded that the general level of earnings for the period from April 2017 to April 2018 (i.e. the 2017/18 tax year) exceeded the general level of earnings at the end of the 2016/17 tax year.

7.12 Average earnings increased by 2.6 per cent in the 2017/18 tax year. That percentage is applied to the current standard amount of the compensation cap (£39,006.18) to provide an uprated standard amount of the cap of £40,020.34 from 1 April 2019. When applying the 90 per cent provision to that uprated standard amount it will provide, at age 65, a maximum level of compensation of £36,018.31.

7.13 For the purposes of this Order, the Secretary of State has made two measurements of the general level of earnings using the Average Weekly Earnings (AWE) estimates, produced by the Office of National Statistics[9], which is the lead measure of earnings growth in Great Britain. Each estimate represents the year on year growth rate for the specified time period; it is not seasonally adjusted but includes bonuses and arrears. The period of time set out in the legislation differs for each measure which is why two different percentage figures are used.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

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[8] See section 50 of and Schedule 20 to the Pensions Act 2014, which amended Schedule 7 to the Pensions Act 2004 to introduce an increased compensation cap for long service: http://www.legislation.gov.uk/ukpga/2014/19/contents

[9] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours

9. Consolidation

9.1 As this instrument does not amend other legislation, consolidation is not applicable. Informal consolidated text of instruments is available to the public free of charge via 'the National Archive' website – www.legislation.gov.uk.

10. Consultation outcome

10.1 Consultation was not considered necessary as this instrument simply enables routine annual uprating.

11. Guidance

11.1 No guidance is being issued on this instrument since it is based on existing legislation. The Department for Work and Pensions will have copies of the instrument and be in a position to explain it to members of the public.

12. Impact

12.1 There is no new direct impact on business, charities or voluntary bodies, as this instrument amends the existing regulatory regime by a pre-determined formula in line with statutory requirements.

12.2 There is no impact on the public sector.

12.3 An Impact Assessment has not been prepared for this instrument.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 This Order will be replaced in 12 months' time, as the primary legislation requires, by a new Order reflecting updated inflation figures.

15. Contact

15.1 Chris Brown at the Department for Work and Pensions(Telephone: 0207 449 7429 or email Chris.Brown11@dwp.gsi.gov.uk) can answer any queries regarding the instrument.

15.2 Joanne Gibson, Deputy Director for Private Pensions Policy at The Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.

15.3 Guy Opperman, Minister for Pensions and Financial Inclusion at the Department for Work and Pension can confirm that this Explanatory Memorandum meets the required standard.