EXPLANATORY MEMORANDUM TO

THE FINANCIAL ASSISTANCE SCHEME (REVALUATION AND INDEXATION AMENDMENTS) REGULATIONS 2011

2011 No. [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 instrument

The Financial Assistance Scheme provides financial assistance to members of certain occupational pension schemes who have lost part or all of their pensions as a consequence of their scheme ending without having enough money to pay full pension benefits. These Regulations will make certain changes to the inflation measure used to determine the Financial Assistance Scheme revaluation, indexation and annual increases to the maximum cap.

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

None.

4. Legislative Context

4.1 On 22 June 2010 the Chancellor of the Exchequer announced that, with some exceptions, the Government proposed to use the Consumer Prices Index rather than the Retail Prices Index as the measure of inflation used to increase most benefits and public sector pensions.

4.2 On 8 July the Minister of State for Pensions made a Written Ministerial Statement to Parliament which announced the Government's intention to use the Consumer Prices Index rather than the Retail Prices Index in determining increases for payments made by the Financial Assistance Scheme (as well as the statutory minimum revaluation and indexation provided by occupational pension schemes and for payment by the Pension Protection Fund). This was because the Minister believes that the Consumer Prices Index is the most appropriate index for that purpose

4.3 These Regulations will allow for the inflation protection given through:

(i) the revaluation of the accrued pension in deferment;
(ii) annual increases to the maximum cap; and
(iii) indexation

for payments by the Financial Assistance Scheme to be calculated using the Consumer Prices Index as the measure of price inflation, replacing the Retail Prices Index which is used at present. The existing caps on indexation and revaluation will continue to apply.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Minister of State for Pensions, Steve Webb MP, has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Assistance Scheme (Revaluation and Indexation Amendments) Regulations 2011 are compatible with the Convention rights".

7. Policy background

- ***What is being done and why***

7.1 It was announced on 14 May 2004 that the Government proposed to establish a Financial Assistance Scheme to help members of defined benefit occupational pension schemes where their scheme had wound up significantly underfunded because of employer insolvency and, as a result, those members had lost part or all of their accrued rights.

7.2 Assistance payments are based on the amount of pension accrued by the individual member at the point the scheme began to wind up and the amount of pension due to each member was fixed. This amount may be revalued in deferment and capped at a specified maximum. Once assistance is paid, it may be indexed.

7.3 Such increases are designed to provide some protection against the value of assistance being eroded by inflation. The calculation of this protection broadly reflected the statutory requirements on the Pension Protection Fund at the time the Financial Assistance Scheme was established which, in turn, reflected the statutory requirements on occupational schemes.

7.4 The Government is changing the statutory requirement on occupational pension schemes, moving from measuring inflation by the Retail Prices Index to the Consumer Prices Index. The decision to amend the Financial Assistance Scheme rules is part of a wider decision to use the Consumer Prices Index as the Government's general measure of inflation for social security benefits, State pensions, public sector pensions, statutory minimum revaluation of private sector pensions and pension compensation provided by the Pension Protection Fund, which will all switch from Retail Prices Index to Consumer Prices Index. The change to the Financial Assistance Scheme is considered

necessary as it would be inappropriate to use a different measure for the Financial Assistance Scheme - which provides help to members of failed occupational pension schemes - than for the legislation governing pension schemes themselves.

7.5 Payments by the Financial Assistance Scheme are capped and that cap is protected against inflation so that, in effect, the level stays the same as the amount guaranteed by the Government as part of its announcement of the final Financial Assistance Scheme settlement in December 2007.

- ***The changes***

7.6 References to the Retail Prices Index are being replaced for relevant periods with a reference to the general level of prices determined in such manner as the Secretary of State thinks fit. The measure of the general level of prices to be used for relevant calculations will be published by the Secretary of State from time to time. The present intention is that the method of determining the general level of prices will be by reference to the Consumer Prices Index.

7.7 The change has been done in this manner, because it is possible there will be more than one Consumer Prices Index at some time in the future and the reference to general level of prices will allow the Secretary of State to designate which Index is to be used without having to amend the legislation again.

7.8 The consequences of this change on the various parts of the assistance calculation are described below.

Revaluation

7.9 Where payment is not made immediately because, for instance, the individual is under pensionable age, the accrued pension can be revalued up to payment age, to protect the value of that pension.

7.10 At present, the accrued pension is revalued according to scheme rules from the date of leaving to the beginning of scheme wind-up. From that point revaluation is according to FAS rules. The level of revaluation applied is in line with the Retail Prices Index up to a cap of 5 per cent compound, to the point the member begins to be paid assistance.

7.11 These Regulations amend the FAS revaluation rate so that it is applied in two separate periods:

7.11.1 from the point of wind-up until 30 March 2011, accruals will revalue in line with the Retail Prices Index; and

7.11.2 from 31 March 2011 to the point assistance comes into payment, accruals will revalue in line with the general level of prices determined in such manner as the Secretary of State thinks fit. The Secretary of State intends that the measure used

to determine the general level of prices will be the Consumer Prices Index.

7.12 A cap of 5 per cent per annum compound will continue to apply over the whole revaluation period from the point of wind-up to the point that assistance comes into payment.

The Financial Assistance Scheme cap

7.13 Where 90 per cent of the expected pension is over a maximum annual amount specified in the Regulations, the expected pension is treated as if it is the amount of that maximum for the purposes of calculating assistance. The amount of the cap is increased on 1 April each year, by the percentage that the Retail Prices Index increased in the year ending in the previous September.

7.14 These Regulations change this so that, from 1 April 2011 the cap will be increased in line with the general level of prices determined in such manner as the Secretary of State thinks fit. The Secretary of State intends that the measure used to determine the general level of prices will be the Consumer Prices Index.

Indexation

7.15 Once payments of assistance begin they can be increased annually. The Financial Assistance Scheme indexes that part of the assistance based on any accruals the member built up from 6 April 1997 in their scheme. This indexation is applied on 1 January each year and is based on increases in the Retail Prices Index over the year to 31 May in the previous year, to a maximum of 2.5 per cent.

7.16 These Regulations allow the Retail Prices Index to be replaced with the general level of prices determined in such manner as the Secretary of State thinks fit. The Secretary of State intends that the Consumer Prices Index will be used for future indexation calculations.

- ***Consolidation***

7.17 This set of Regulations amends the Financial Assistance Scheme Regulations 2005 (SI 2005/1986).

7.18 The Government is aware that the Financial Assistance Scheme Regulations have now been amended a number of times and would benefit from consolidation. The Department is therefore currently working on consolidating the Financial Assistance Scheme Regulations and intends to lay a set of Financial Assistance Scheme Regulations before Parliament early next year which will make certain technical changes as well as consolidating all the previous amendments.

8. Consultation outcome

8.1 A consultation, which covered the changes in these regulations, similar changes proposed for the Pension Protection Fund and possible changes to the synthetic buy-out basis ran from 12 August 2010 to 3 November 2010. A total of 46 responses to the consultation were received, of which 14 were from organisations involved in pensions.

8.2 Affected members and their representatives were opposed to the proposed change, as increases based on the Consumer Prices Index are generally lower than those based on the Retail Prices Index. They also felt that the Consumer Prices Index did not adequately reflect the level of inflation faced by pensioners. The Government has noted Respondents' concerns about the use of the Consumer Prices Index in the revaluation and indexation of Assistance but it continues to believe that the Consumer Prices Index is the most appropriate index for that purpose.

8.3 Reactions from those working in the pension field were more neutral and focused on the technical application of the change.

8.4 A more detailed analysis of and response to the consultation will be published on the on the Department's website shortly.

9. Guidance

9.1 Staff responsible for operating the changes to the Financial Assistance Scheme will be trained in the new provisions. The Financial Assistance Scheme's leaflets and website will be amended to reflect the new provisions as soon as practically possible.

10. Impact

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

10.2 A full impact assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The Board of the Pension Protection Fund, as the Financial Assistance Scheme Manager, is required to provide a report to the Secretary of State for Work and Pensions at the end of each financial year on the operation of the Financial Assistance Scheme including the number of persons who have received payments under the Financial Assistance Scheme Regulations 2005 (as amended) and the total amount of those payments. The first report by the Board must be provided as soon as practicable after 31 March 2010 and annually thereafter. This report is laid before Parliament when received by the Secretary of State.

12.2 Where any part of that Report raises concerns over the operation of the Financial Assistance Scheme, the Department for Work and Pensions will take the appropriate action, which could include flagging its concerns with the Board or adjusting targets.

13. Contact

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