EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND (PENSION COMPENSATION CAP) ORDER 2011

2011 No. [DRAFT]

THE OCCUPATIONAL PENSION SCHEMES (LEVY CEILING – EARNINGS PERCENTAGE INCREASE) ORDER 2011

2011 No. 169

AND

THE OCCUPATIONAL PENSION SCHEMES (LEVY CEILING) ORDER 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 instruments

These three Orders are made each year to increase two amounts used for the Pension Protection Fund (PPF). The increases ensure that rises in average earnings are taken into account in the value of these two amounts, so that they retain their value. The two amounts are:

- the compensation cap, which helps control 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

None

4. Legislative Context

<u>Compensation Cap Order</u>

4.1 This Order sets out the level of the compensation cap for the PPF from 1st April 2011 as a result of a review by the Secretary of State of the general level of earnings in the 2009/2010 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 he

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. He concluded that the general level of earnings for the period from April 2009 to April 2010 (i.e. the 2009/10 tax year) exceeded the general level of earnings at the end of the period taken into account for the last such review by 0.5 per cent. The period for the last such review, for the purposes of the current Compensation Cap Order (S.I. 2010/667), was the 2008/2009 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 0.5 per cent in the 2009/2010 tax year. That percentage is applied to the current compensation cap, which provides an uprated cap of £33,219.36. When applying the 90 per cent provision to that uprated cap it will provide, at age 65, a maximum level of compensation of £29,897.42.

Levy Ceiling (Earnings Percentage Increase) Order

4.6 This Order specifies the increase in the general level of earnings for the year ending on 31st July 2010, for the purposes of uprating the levy ceiling for the financial year beginning on 1st April 2011.

Levy Ceiling Order

4.7 This Order specifies the amount of the levy ceiling for the financial year beginning on 1st April 2011. 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 £871,183,684 came into effect on 1st April 2010 (S.I. 2010/666).

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 2.4 per cent during the year from 1st August 2009 to 31st July 2010. The Secretary of State is therefore required to prescribe that percentage in the Occupational Pension Schemes (Levy Ceiling – Earnings Percentage Increase) Order 2011.

4.11 The 2.4 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 method 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. A person's earnings are a significant factor in determining the level of their pension, which in turn determines the level of pension compensation they are entitled to from the PPF.

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 2011 as £892,092,092.

5. Territorial Extent and Application

These instruments apply to Great Britain.

6. European Convention on Human Rights

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

"In my view the provisions of the Pension Protection Fund (Pension Compensation Cap) Order 2011 and the Occupational Pension Schemes (Levy Ceiling) Order 2011 are compatible with the Convention rights".

6.2 As the Occupational Pension Schemes (Levy Ceiling - Earnings Percentage Increase) Order 2011 is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

7.1 The Pensions Act 2004 established the PPF, a statutory fund run by the Board of the PPF, which is 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 may have an influence over their scheme, to try to ensure that 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 The PPF is funded by a number of sources including:

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

7.5 The pension protection levy comprises of a risk based levy (required by law to be at least 80 per cent of the total) and a scheme based levy making up the remainder. The scheme based levy is calculated on the level of a scheme's liabilities and the risk based levy is calculated on scheme underfunding and the likelihood of insolvency.

7.6 The levy ceiling is a statutory control that prevents the Board of the PPF from raising the total 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

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

7.8 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

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 he makes these types of Order. The Orders do not change policy, are routine, used 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.

9.2 DWP includes a copy of these Orders in the Blue Books, which are available for free on the internet.

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

This legislation does not apply to business.

12. Monitoring & review

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