

**EXPLANATORY MEMORANDUM TO**  
**THE PENSION PROTECTION FUND (PENSION COMPENSATION CAP) ORDER**  
**2008**

**2008 No.**

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 2008 as a result of a review by the Secretary of State of the general level of earnings in the 2006/2007 tax year.
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 (“the Act”) requires the Secretary of State to make an Order which specifies the amount of the compensation cap.
  - 4.2 Paragraph 27 of Schedule 7 to the Act 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, he 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 Act requires the Order to provide that the increase is to have effect from the 1st April next following the end of the tax year to which the review relates.
  - 4.4 The Secretary of State reviewed the general level of earnings in Great Britain in the 2006/2007 tax year and concluded that the general level exceeded by 3.1 per cent the general level at the end of the period taken into account for the last review.
  - 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.
  - 4.6 The level of compensation payable by the Board of the PPF (the Board) to members who are below their scheme’s normal pension age, when the sponsoring employer of the member’s pension scheme was subject to a qualifying insolvency event, is limited to a maximum of 90 per cent of the compensation cap unless they took early retirement under the scheme’s ill-health provisions.

- 4.7 The current compensation cap is £29,928.56. Where the cap applies, the member's compensation entitlement is calculated by applying paragraph 26 of Schedule 7 to the Act and reducing the resulting amount to 90%. This provides that the total value of compensation payments for members below normal pension age does not exceed £26,935.70 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.
- 4.8 Average earnings, as measured by the Average Earnings Index and published by the Office of National Statistics, increased by 3.1 per cent in the 2006/2007 tax year. If that percentage is applied to the current compensation cap this will provide an uprated cap of £30,856.35. When applying the 90 per cent provision and the uprated cap it would provide, at age 65, a maximum level of compensation of £27,770.72.
- 4.9 Article 2 of this Order specifies that the compensation cap shall be £30,856.35 from 1st April 2008, as required by paragraph 27(2) and (3) of Schedule 7 to the Act.

## **5. Territorial Extent and Application**

- 5.1 This instrument applies to Great Britain.

## **6. European Convention on Human Rights**

Mike O'Brien, 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 2008 are compatible with the Convention rights.

## **7. Policy background**

- 7.1 The Act established the PPF, a statutory fund run by the Board who are a body corporate, 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.
- 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 survivors' 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 PPF compensation is funded in three ways – by means of levies charged to all eligible 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.
- 7.4 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 PPF compensation levels or scheme benefit levels, whichever is lower.
- 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. All assets and liabilities of the scheme transfer to the PPF and the trustees or managers are discharged of their responsibilities towards the scheme.
- 7.6 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*

- 7.7 There is no statutory requirement upon the Secretary of State to consult before he makes this Order under the Act.

#### *Guidance*

- 7.8 DWP will be in a position to explain the provisions of this Order. Guidance on the Compensation Cap is also available on the PPF website at: [http://www.pensionprotectionfund.org.uk/index/other\\_guidance/compensation\\_cap\\_factors.htm](http://www.pensionprotectionfund.org.uk/index/other_guidance/compensation_cap_factors.htm)

#### *Consolidation*

- 7.9 The compensation cap is updated 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 An Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.
- 8.2 There is no impact on the public sector.

### **9. Contact**

Any queries regarding this instrument are to be directed to Jimmie Yardley at the Department for Work and Pensions Tel: 0207 962 2740 or e-mail: [Jimmie.yardley1@dwp.gsi.gov.uk](mailto:Jimmie.yardley1@dwp.gsi.gov.uk)