EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (LEVIES) (AMENDMENT) REGULATIONS 2006

2006 No.935

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 The Board of the Pension Protection Fund ("the Board") is a body corporate established by section 107 of the Pensions Act 2004 (c.35) ("the Act"). The Pension Protection Fund (PPF) Ombudsman is a commissioner established by section 209(1) of the Act.

2.2 This instrument amends the Occupational Pension Schemes (Levies) Regulations 2005 ("the Levies Regulations")[1].

2.3 For the financial year 2006/07, it replicates the amounts charged for the administration levy in 2005/06 as provided for in section 117 of the Act.

2.4 It also replicates for 2006/07 the amount for the PPF Ombudsman levy, as provided for in section 209 of the Act. That levy is again not payable for the year 2006/07 (because of the small sums likely to be needed that year).

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

3.1 None.

[1] S.I. 2005/842

4. Legislative Background

4.1 The Act received Royal Assent 18 November 2004. The Board is an executive non-departmental public body which will pay compensation to members of eligible pension schemes when the employer is insolvent and the pension scheme is underfunded.

4.2 Section 117 of the Act provides for an imposition of an administration levy, in respect of eligible schemes, to meet:

- Expenditure of the Secretary of State relating to the establishment of the Board

- Any expenditure of the Secretary of State which he pays the Board towards its expenses out of money provided by Parliament.

4.3 Section 126 of the Act makes provision about which occupational pension schemes are eligible schemes.

4.4 Section 209 (1) of the Act establishes the office of the PPF Ombudsman, appointed by the Secretary of State for Work and Pensions. Sections 213 and 214 of the Act provide for the PPF Ombudsman to investigate and determine references of “reviewable matters” and complaints of maladministration. Section 209(7) provides for regulations to impose a levy on eligible schemes.

4.5 The Levies Regulations provide for trustees or managers of eligible occupational pension schemes to pay an administration levy in respect of the financial year 2006/07 to the Secretary of State for Work and Pensions. S.I. 2005/842 as amended by these Regulations sets out how the levy amount varies for schemes of different sizes. The Regulations also provide for trustees or managers of eligible schemes to pay a PPF Ombudsman levy to the Secretary of State. As for the 2005/06 year, the PPF Ombudsman levy is not payable for the year 2006/07 (because of the small sums likely to be needed).

5. Extent

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

The Minister of State for Pensions Reform, Stephen Timms, has made the following statement regarding Human Rights:

In my view the provisions of the Occupational Pension Schemes (Levies) (Amendment) Regulations 2006 are compatible with the Convention rights.

7. Policy background

7.1 The administrative costs of the Board are to be kept separate from the Pension Protection Fund which the Board manages. The administration levy on eligible schemes means that they, rather than the general taxpayer, will fund the Board's administration costs (as for the pension compensation costs). The administration levy covers expenditure by the Secretary of State in establishing the Board, and will recoup money provided by Parliament towards the expenses of the Board

7.2 The costs of the PPF Ombudsman are initially paid by the Secretary of State, but will be recouped via the PPF Ombudsman levy, so that the costs fall on eligible schemes with access to his office, rather than by the general taxpayer – once that levy is charged in future years.

7.3 This instrument was consulted on for a period of 8 weeks by inclusion in a consultation document that sought the views of, for example, employers, pension scheme administrators, trustees and managers, lawyers, pension scheme members and their representatives. A list of consultees is at Annex C. A single response was received for this instrument, from the Board, concerning a technical issue. No amendments were needed as a result because existing provisions in SI 2005/441 ensure that the outcome desired by the Board is achieved.

8. Impact

8.1 An assessment of the impact on business, charities or the voluntary sector of the provisions in this instrument for the administration levy was included in the Regulatory Impact Assessment that accompanied the Pensions Act 2004. A copy of the full assessment has been placed in the libraries of both Houses of Parliament. Copies may be obtained from the Department for Work and Pensions, Better Regulation Unit, Level 4, Adelphi, 1-11 John Adam Street, London WC2N 6HT, relevant extract attached at Annex A/B.

8.2 The provisions in these regulations for the PPF Ombudsman levy will have no cost impact on the public sector in 2006/7.

9. Contact

Jacob Soper at the Department for Work and Pensions Tel: 0207 962 8645 or e-mail Jacob.soper@dwp.gsi.gov.uk with any queries regarding the instrument.

Annex A to Explanatory Memorandum

Extract from the Pensions Bill Regulatory Impact Assessment

3.1 The Pension Protection Fund

3.2.1 The Bill introduces a compensation scheme for private sector DB and hybrid[2] occupational pension schemes in the UK, run by a statutory body known as the Pension Protection Fund (PPF). Where the sponsoring employer has become insolvent, and the pension scheme has insufficient assets to cover the PPF level of benefits by means of annuity purchase, the PPF will take over the assets of the scheme and pay compensation to scheme members. The risk of doing nothing is that individuals whose employer becomes insolvent can end up with only a fraction of the pension that they expected. The PPF will in general compensate to 100% of the amount of pension in payment (or accrued) for people over the scheme's normal pension age (as well as survivors and ill-health pensioners), and 90% of the accrued level of pension entitlement for people under normal pension age.

Miss Garnett has a deferred pension in a scheme where the employer fails
Miss Garnett is aged 42 and has a preserved pension in a scheme following redundancy a couple of years ago. The preserved pension is £2,500 a year, based on 20 years' service and final earnings of £9,000, plus a little revaluation. She worked for a small engineering firm based in the North West of England. The firm is close to insolvency. If the company did become insolvent, the pension scheme would have liabilities of £2.2 million and assets of £1.3 million. The liabilities of pensioners account for £0.65 million. Pensioners would be paid in full, leaving assets of £0.65 million and liabilities of £1.55 million for non-pensioners. This means that working age members of the scheme would receive only around 42% of the value of their accrued rights on the MFR basis. In the case of Miss Garnett, this amounts to a transfer value which would generally produce a pension of less than 42% of her accrued rights – that is, less than £1,050 a year. The investment risk over the period to retirement means that the pension could be substantially lower. Alternatively if a guaranteed deferred annuity were bought with the transfer value the amount of the pension secured might be as little as £600 per year.

5 Hybrid schemes can take a large variety of forms, but all include both defined benefit and defined contribution elements

If the PPF had existed to guarantee Miss Garnett's pension at 90%, she would have had a guaranteed pension of £2,250 per year, £1,200 per year more than the pension supposedly provided by her MFR based transfer value, and over £1,600 per year greater than that which could be secured by the purchase of a deferred annuity. The PPF could have more than tripled her income devised from occupational pension rights in retirement.

3.2.2 The compensation scheme will be funded by a levy on those schemes providing defined benefit pension provisions and DB elements of hybrid schemes. The responsibility for payment of the levies rests with the scheme trustees or managers**.** However we expect, in practice, that sponsoring employers will bear the brunt of the costs of the levies.

3.2.3 The Bill requires at least 50% of the levy to be based on the level of scheme underfunding relative to the costs of securing the PPF level of compensation and other possible risk factors, such as the risk of sponsor insolvency and the investments of the scheme relative to its liabilities. The remainder of the levy should be assessed with reference to scheme factors such as the number of members or the amount of the liability. However for practical reasons it will not be possible for this to be in place immediately when the PPF starts. There will therefore be an initial levy (the first levy) set by the Secretary of State and a further transitional period when modifications may be made to the provisions governing the PPF Board's setting the levy in the light of practical considerations.

3.2.4 The following table illustrates a very simplified structure for the levy based only on allowing for underfunding (relative to securing the PPF level of compensation as a risk factor). It is intended that when the PPF is able to implement the levy procedures in full it will include other risk factors. This is based on the assumption that the total levy would be about £300 million, with 80% of the total derived from a risk-factor based levy.

Funding level relative to PPF level of compensation	**Levy/Premium**
Over 100% funded	Scheme factor levy only
Between 80% and 100% funded	Scheme factor rate levy; risk-based levy of £4 per £1,000 of under-funding
Under 80% funded	Scheme factor levy; risk-based levy of £4 per £1,000 of under-funding for first 20% of under-funding, plus £8 per £1,000 of under-funding for rest of the under-funding.

3.2.5 On this basis, and assuming that there was a levy of £4 per member (including active, deferred and pensioner members), the amount of levy for three specimen schemes is shown in the following table.

	Scheme A	Scheme B	Scheme C
Number of Members	1,000	20,000	50,000
Assets	£30 million	£900 million	£2,000 million
PPF benefit Liability	£40 million	£1,000 million	£2,500 million
Underfunding	£10 million (75%)	£100 million	£400 million (80%)
Scheme factor levy	£4,000	£0.08 million	£0.2 million
Risk Factor based levy	£48,000	£0.4 million	£1.6 million
Total levy	£52,000	£0.48 million	£1.8 million

Summary of options and impact of consultation

3.2.6 An alternative option which was considered was a “central clearing house” which would take in the assets of pension schemes and purchase annuities on behalf of members (deferred in the case of those under retirement age), but it would not top up those assets. This was rejected because it would still leave members at risk of losing all or most of their pension. Of the respondents who commented on the proposal to introduce an insurance scheme, 53% agreed with some form of insurance, 28% were neutral and 19% were not in favour at all. Of the respondents who commented on the option of a “centralised clearing house”, 35% were in favour of the proposal and 29% disagreed.

3.2.7 Also considered was whether the assets of a scheme whose sponsor is insolvent should be topped up to the level needed to insure the scheme benefits, or some specified lower level of benefits, on winding up. As with the PPF, a levy would have been needed to meet the costs. This was rejected in favour of the PPF where instead of insuring the benefits, the PPF will operate in a manner similar to a pension scheme, by paying the amount of compensation as they payments become due. The PPF approach was considered to provide a more stable approach to the meeting the costs of any underfunding by being better able to smooth the levy over time.

Costs including Savings and Benefits

3.2.8 The costs across all employers with DB pension schemes will be approximately £300 million a year, depending on the level of the guarantee opted for. This is based on the assumption that 90% of a pension for a member below normal pension age will be protected, up to a maximum of £25,000 a year, with 100% of the pension in payment guaranteed for pensioners over the scheme normal pension age and for survivors and ill-health pensions in payment. The amounts of pension which have accrued to members since April 1997 will be indexed in line with changes to the retail price index subject to a maximum of 2.5% a year. In order to meet the running costs of the PPF, a separate flat-rate administration levy will be introduced. This is estimated to incur a cost of £15 million a year across all schemes.

Impact on different business sectors

3.2.9 *There is no reason to believe that different business sectors will be affected in different ways. This proposal will only affect private sector DB schemes. The* *intention is to minimise the impact on small businesses. Schemes with fewer than 100 members will be subject to a simpler approach to determining the levy in order to reduce the administration costs to them.*

Securing compliance

3.2.10 The requirement to pay the PPF levy will be set out in legislation. Failure to make relevant payments will be sanctionable by The Pensions Regulator.

Annex B to Pensions Bill Regulatory Impact Assessment- Proposals resulting in an administrative net cost (on an on-going basis)

Proposal	Admin costs (these are the on-going annual admin costs)	Start-up/one-off admin costs
Pension Protection Fund	£15m	-
The Pensions Regulator - increase in levy	£6m	£6m
Trustee Investment Decisions	£9m	£17m (but spread over a 3 year period)
Scheme Specific Funding	£17m	£25m
Transfer Values for Early Leavers	£5m	-
Requirement to Consult Employees	£2.5m*	-
Combined Pensions Forecasting	Minimal	For small schemes using third-party insurers the costs could be between £500 and £5,000 and for larger schemes - administering pensions in-house the costs could be between £10,000 and £50,000

* Administrative costs arising from the Requirement to Consult are estimated to be between £2.2m and £2.8m, depending on the provisions made in the regulations for small employers. The figure of £2.5m is the mid-point of these two possibilities.

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the Secretary of State for Work and Pensions, Andrew Smith

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Date …………………………………………….

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Annex C to Explanatory Memorandum: List of Consultees

Association of British Insurers
Association of Consulting Actuaries
Association of Pension Lawyers
Association of Pensioner Trustees
Auditing Practices Board
Better Regulation Executive
British Chamber of Commerce
Confederation of British Industry
Consumers Association
Council on Tribunals
Engineering Employers Federation
Federation of Small Businesses
Financial Services Authority
HM Treasury (MOCOP)
HM Revenue and Customs
Industry Wide Pension Schemes Group
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants in Scotland
Institute of Directors
Investment Managers' Association
NAPF
National Consumers Council
Office of Fair Trading
Pensions Ombudsman
Pension Protection Fund Ombudsman
Policy and Legal Division DHSS Northern Ireland
Small Business Service
The Association of Corporate Trustees
The Faculty and Institute of Actuaries
The Law Society of England and Wales
The Law Society of Scotland
The Pensions Management Institute
The Pensions Protection Fund
The Pensions Regulator
The Scottish Executive
The Society of Pension Consultants
The Welsh Assembly
TPAS (the Pensions Advisory Service)
Trades Union Congress