EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND (CONTRIBUTIONS EQUIVALENT PREMIUM) REGULATIONS 2007

2007 No. 834

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 These regulations ensure that trustees of defined-benefit occupational pension schemes are able to pay a contribution equivalent premium (CEP) in respect of a contracted-out employee during a Pension Protection Fund ("PPF") assessment period. They also allow the CEP to be paid by the Board of the Pension Protection Fund ("the Board" of the PPF) in certain circumstances where a CEP has not been paid by the trustees before a scheme enters the PPF, and make corresponding provisions in respect of Northern Ireland.

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

3.1 None

4. Legislative background

4.1 Under section 55 of the Pensions Schemes Act 1993 (PSA), where a person has been a member of a contracted out occupational pension scheme for less than two years and is under pension age, the schemes trustees may pay a CEP to Her Majesty's Revenue and Customs which, through the effect of section 48A of that Act, reinstates that person's entitlement to state second pension for that contracted out period instead of any scheme benefits they might otherwise have qualified for on the basis of their contracted out contributions. Where the person has no accrued right to benefit under the scheme, the scheme's trustees are required to pay a CEP. Under section 57 the trustees can also elect to pay a CEP in certain circumstances. Where trustees are required by the PSA to pay a CEP and fail to do so, they can be liable, on conviction under section 67, for a fine.

4.2 The Regulations ensure that restrictions placed upon the trustees or managers of pension schemes that enter an assessment period for the PPF under section 135(4) of the Pensions Act 2004 (the PA), are compatible with their duties under the PSA in relation to the payment of CEPs, and to ensure that the Board can pay CEPs in certain circumstances.

4.3 Corresponding provision is made for Northern Ireland by sections 44A, 51, 53 and 63 of the Pension Schemes (Northern Ireland) Act 1993 and Article 119 of the Pensions (Northern Ireland) Order 2005.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom (see 5.2).

5.2 Regulation 1 of this instrument in so far as it relates to regulations 4, 6 and 8, and regulations 4, 6 and 8 apply to the Great Britain, regulation 1 in so far as it relates to regulations 5, 7 and 9 and regulations 5, 7 and 9 apply to Northern Ireland.

6. European Convention on Human Rights

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

7. Policy Background

The Pension Protection Fund

7.1 The PPF was set up under provisions in the PA to provide a statutory level of compensation to members of eligible defined benefit and hybrid occupational pension schemes when an employer becomes insolvent, 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 It is funded by means of levies charged to all eligible schemes (i.e. schemes which can claim PPF compensation) and any assets remaining in schemes which transfer to the PPF at the end of an assessment period.

7.3 Where an employer has an insolvency event and the pension scheme has insufficient funds to pay PPF compensation levels (protected liabilities) the scheme enters an assessment period. During this period a valuation is undertaken to determine the amount of assets in the scheme against members protected liabilities. Benefits payable by the trustees during the assessment period are restricted to PPF compensation levels.

7.4 At the end of the assessment period if the valuation shows that the scheme assets are insufficient to pay protected liabilities the scheme enters the PPF. The property, rights and liabilities transfer to the Board of the PPF and the trustees or managers are discharged of their responsibilities towards the scheme and the scheme is treated as if it were wound up. The Board is then responsible for providing compensation out of the PPF in accordance with compensation provisions.

7.5 At the end of the assessment period if the valuation shows that assets are sufficient to pay at least protected liabilities, the PPF has no further involvement with the scheme and it is required to wind up outside the PPF.

Pension Schemes Act 1993 (PSA) requirements

7.6 Where a member has been:

- in contracted-out service for less than two years, and
- is under pension age,

the trustees *may* in certain circumstances, notify HMRC within six months of the cessation of contracted-out service that they have elected to pay a CEP. Where the member had no accrued rights the trustees *must* pay a CEP. In both cases the CEP must usually be paid to HMRC six months after cessation of service.

Pensions Act 2004 requirements

7.7 Where an insolvency event occurs an eligible pension scheme will enter a PPF assessment period. During this time the trustees or managers will pay pensions and benefits at PPF compensation levels and there can be no new accruals of scheme benefits. They cannot make any other payments out of the scheme or discharge any liabilities unless they are specifically authorised to do so e.g. they may pay certain transfer values. An assessment period must last a minimum of twelve months.

7.8 At the end of the assessment period, if a scheme rescue has not been possible and the valuation shows that the scheme cannot afford PPF compensation levels, the Board assumes liability for the scheme, and rights, responsibilities and liabilities transfer to the Board. The trustees or managers are discharged of their responsibilities to the scheme and the scheme is treated as having wound up.

7.9 Where a member has:

- less than three months service which is terminated by the start of an assessment period,
- has no relevant accrued rights, but
- has a right under the scheme rules to a contribution refund or transfer payment (but not to a cash transfer or refund under Chapter 5 of Part 4 of the PSA),

the member is entitled to compensation by way of a lump sum payable to the member at a rate of 90% of his contribution payments (employee contributions only) or a transfer payment at a rate of 90%

(see paragraph 20 of schedule 7 to the Pension Act 2004).

7.10 Where a member has three months service or more, he is treated as having relevant accrued rights in the scheme and is entitled to compensation when he reaches pension age.

7.11 However, where a member has:

- less than three months service which is terminated by the start of an assessment period,
- no relevant accrued rights,
- no rights under the scheme rules to a contribution refund or transfer payment, and
- no right to a cash transfer or refund under Chapter 5 of Part 4 of the PSA,

the member is not entitled to any form of compensation.

Issues

7.12 The provisions of the PA and the PSA are not compatible. The PSA requires trustees to pay a CEP within six months of contracted-out employment ceasing but the PA does not permit the trustee to pay this liability under the PPF compensation provisions. The PA also does not allow trustees to elect to pay a CEP where a member's contracted-out service ceases during an assessment period.

7.13 If the trustees fail to pay the CEP within the prescribed time limit the CEP cannot be paid and the trustees or managers may be liable to conviction or penalty. These regulations therefore create provisions to extend the time limit when the trustees may pay a CEP. Where the CEP has not been paid by the time a scheme is transferred to the PPF, the Board will pay it in certain circumstances.

7.14 Where the scheme is transferred to the PPF liability to pay the CEP to HMRC will transfer to the Board. However the Board will only pay a CEP if the member is not entitled to any PPF compensation or is only entitled to compensation under paragraph 20 of Schedule 7 to the PA. The compensation will be reduced to reflect that a CEP has been paid.

7.15 The regulations provide -

- that CEPs can be paid by the trustees of a scheme where the liability arose before the assessment period commenced (Regulation 2).

- for the circumstances in which a liability to pay a CEP can arise and be paid by the trustees or managers during an assessment period (Regulation 3).

- that the Board of the PPF shall be required to discharge its liability to pay a CEP (Regulation 4 and Regulation 5 in relation to Northern Ireland).

- the circumstances in which a CEP is not payable by the Board (Regulation 6 and Regulation 7 in relation to Northern Ireland).

- for deductions from the amount of the CEP where a person is entitled to certain payments upon leaving the scheme (Regulation 8 and Regulation 9 in respect of Northern Ireland).

Northern Ireland

7.16 Regulations 5, 7 and 9 make provision for Northern Ireland corresponding to regulations 4, 6, 8 .

Consultation

7.17 In accordance with section 317(1) of the PA, the Secretary of State has consulted, respectively, with the Board of the PPF and such persons as he considers appropriate. The consultation period ran from 2 August to 24 October 2006.

7.18 A list of those consulted is provided in the Annex to this memorandum. Three responses were received, all of which were supportive of the proposed provisions. A full response to the consultation is published on the DWP website - http://www.dwp.gov.uk/consultations/2006/

7.19 Following the consultation the Regulations were redrafted to make them less complex by relying on existing provisions where appropriate. In addition, corresponding provisions relating to Northern Ireland were incorporated as appropriate.

Guidance

7.20 Information on the paying of CEPs is currently provided by Her Majesty's Revenue and Customs, and information on the restrictions applying to trustees and managers of pension schemes is currently provided by a range of sources including the PPF and the Pensions Regulator. The Government will work with those bodies to ensure that updated information is available as soon as practicable.

Consolidation

7.21 This Statutory Instrument amends a number of other instruments. The Government will keep under review whether there is a case for the consolidation of Instruments relating to the Pension Protection Fund.

8. Impact

8.1 A Regulatory Impact Assessment has not been published for this instrument as it has only a negligible impact on business, charities and voluntary bodies.

8.2 The impact on the public sector is nil.

9. Contact

Any enquiries about the contents of this memorandum should be addressed to: Mr J Barker, Department for Work and Pensions, Pension Protection and Stewardship Division, telephone: 020 7712 2754 or email: julian.barker@dwp.gsi.gov.uk

Annex A

List of those consulted

Association of British Insurers
Association of Consulting Actuaries
Association of Pension Lawyers
Association of Pensioneer 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