

**EXPLANATORY MEMORANDUM TO
THE PENSION PROTECTION FUND (REVALUATION AMENDMENTS)
REGULATIONS 2011**

2011 No. 554

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

2.1 The Board of the Pension Protection Fund is a statutory corporation set up in 2005. It pays pension compensation from the Pension Protection Fund to members of eligible defined benefit and hybrid occupational pension schemes. Compensation may be paid when a scheme's sponsoring employer becomes insolvent and the scheme cannot afford to pay members' benefits at the same level as the pension compensation provided by the Pension Protection Fund. These Regulations will make certain changes to the inflation measure used to determine the revaluation applied to accrued pensions before entitlement to compensation begins.

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

3.1 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 Parliament¹ which announced the Government's intention to use the Consumer Prices Index rather than the Retail Prices Index in determining increases for compensation payments made by the Pension Protection Fund (as well as the statutory minimum revaluation and indexation provided by occupational pension schemes and for payments by the Financial Assistance Scheme). This was because the Minister believes that the Consumer Prices Index is the most appropriate index for that purpose.

4.2 These Regulations will allow for the inflation protection given through the revaluation of the accrued pension in deferment for relevant periods to be calculated using the general level of prices determined in such manner as the Secretary of State may from time to time decide, rather than the Retail Prices Index. The present intention is that the method of determining the general level of prices will be by reference to the Consumer Prices Index. The existing caps on revaluation will continue to apply.

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4.3 Similar changes in respect of the indexation of pension compensation require amendments to primary legislation and these are being taken forward through the Pensions Bill laid before Parliament on 12 January 2011.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

6.1 As the Pension Protection Fund (Revaluation Amendments) Regulations 2011 are subject to the negative resolution procedure and do 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 Pension Protection Fund: a statutory fund run by the Board of the Pension Protection Fund, who are a corporate body, from 6th April 2005. The Pension Protection Fund 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 pension compensation levels. An insolvency event is typically when an employer does not have sufficient funds to pay its debts, buy goods, etc.

7.2 For the majority of people below their scheme's normal pension age, the Pension Protection Fund will pay a 90 per cent level of compensation subject to the compensation cap and Pension Protection Fund rules. This generally means 90 per cent of the accrued pension immediately before the beginning of the assessment period, revalued to the first date of payment. Currently that revaluation is based on the Retail Prices Index, subject to a cap that can be either 5 per cent or 2.5 per cent depending on the period the benefits were accrued.

7.3 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 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 assistance provided by the Financial Assistance Scheme, which will all switch from the Retail Prices Index to the Consumer Prices Index.

- *The changes*

7.4 References to the Retail Prices Index are being replaced for relevant revaluation periods with a reference to the general level of prices determined in such manner as the Secretary of State may from time to time decide. The Secretary of State will publish the method for determining the general level of prices. The present intention is that the method of determining the general level of prices will be by reference to the Consumer Prices Index.

7.5 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 or an alternative index which may be more appropriate 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.

Revaluation

7.6 At present, Pension Protection Fund legislation provides for the accrued pension to be revalued according to scheme rules from the date of leaving the scheme to the beginning of scheme wind-up. From that point revaluation is according to Pension Protection Fund rules. The level of revaluation applied is in line with the Retail Prices Index up to a cap of 5 per cent compound for any accruals on or before 5 April 2009 and 2.5 per cent compound for any accruals from 6 April 2009 to the point the member begins to be paid compensation.

7.7 These Regulations amend the Pension Protection Fund revaluation rules so that it is applied in two separate periods:

7.7.1 from the point of wind-up until 30 March 2011, accruals will revalue in line with the Retail Prices Index, subject to the relevant cap; and

7.7.2 from 31 March 2011 to the point compensation comes into payment, accruals will revalue in line with the general level of prices determined in such manner as the Secretary of State may from time to time decide, also subject to the relevant cap. The Secretary of State intends that the measure used to determine the general level of prices will be the Consumer Prices Index.

7.8 The current caps described above will continue to apply over the relevant periods.

• *Consolidation*

7.9 This set of Regulations amends the Pension Protection Fund (Compensation) Regulations 2005 (SI 2005/670).

7.10 Consolidation of the regulations included within this instrument will be included in due course in the Department's "The law relating to Social Security" (the Blue Volumes), which are available at no cost to the public on the internet at - <http://www.dwp.gov.uk/advisers/docs/lawvols/bluevol/>

8. Consultation outcome

8.1 A consultation, which covered the changes in these regulations and similar changes proposed for the Financial Assistance Scheme ran from 12 August 2010 to 3 November 2010. A total of 46 responses to the consultation were received from a mix of organisations involved in pensions, members of either the Pension Protection Fund or the Financial Assistance Scheme and their representatives.

8.2 Comments from pensions professionals were broadly neutral on the proposals to move to using the Consumer Prices Index as they felt it was for the Government to decide the most appropriate measure of inflation to use.

8.3 Members and representative groups mainly focused on the proposed changes to the Financial Assistance Scheme. However, they were opposed in principle to replacing the Retail Prices Index with the Consumer Prices Index, as they believe it would, over time, provide lower compensation payments. They raised concerns that the change was only being made to save money for the Pension Protection Fund and employers.

8.4 The Government has noted Respondents' concerns about the use of the Consumer Prices Index in the revaluation and indexation of pension compensation but it continues to believe that the Consumer Prices Index is the most appropriate index for that purpose.

8.5 Pensions professionals also questioned the appropriateness of the draft provision in respect of the section 143 test applied by the Pension Protection Fund to determine scheme entry. In light of these concerns and after further consideration the Government has decided to remove the relevant provision.

8.6 A more detailed analysis of and response to the consultation has been published on the Department's website.

9. Guidance

9.1 Staff responsible for operating the changes to the Pension Protection Fund will be trained in the new provisions. The Pension Protection Fund'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 charities, the public sector or voluntary bodies.

10.2 As mentioned above, the Government is proposing to move from the Retail Prices Index to the Consumers Prices Index as a measure for increases to pension compensation in payment. This requires amendments to primary legislation and these are being taken forward through the Pensions Bill laid before Parliament on 12 January 2011.

10.3 It was not possible to separate out the impact on business of the changes in these regulations to revaluation and the changes in the Pensions Bill to increases in payment. Therefore the impact of the revaluation changes delivered by these regulations is included in the full impact assessment which has been prepared for the Pensions Bill currently before Parliament.

10.4 An Equality Impact Assessment has been prepared for these Regulations and has been published on the Department's website.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The Department for Work and Pensions and the Board of the Pension Protection Fund work together to review the effectiveness of legislation on the Pension Protection Fund.

13. Contact

13.1 Marc Swaby at the Department for Work and Pensions - Tel: 020 7449 7433 or email: Marc.Swaby@dwp.gsi.gov.uk - can answer any queries regarding the instrument.