EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND (MISCELLANEOUS AMENDMENTS) REGULATIONS 2012

2012 No. 1688

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 This instrument makes various amendments to existing secondary legislation to change how the assets and liabilities of an occupational pension scheme can be valued as part of the assessment process for entry to the Pension Protection Fund. It also makes changes to the information a scheme has to provide when making an application to be reconsidered for entry to the Fund.

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

None.

4. Legislative Context

4.1 Provisions in the Pensions Act 2011 which amend the Pensions Act 2004 are being commenced (in a separate commencement order). The provisions being commenced make two changes to how the Pension Protection Fund operates.

4.2 The first set of amendments to the primary legislation deal with how the Board of Pension Protection Fund is required to assess the assets and liabilities of a scheme applying for entry to the Pension Protection Fund. Under section 143 of the Pensions Act 2004 the Board of the Pension Protection Fund is required to obtain an actuarial valuation. The changes will permit the Board, where it is able to do so, to determine the funding position of an eligible scheme without obtaining an actuarial valuation. As a consequence this instrument amends existing secondary legislation where it makes reference to valuations under section 143.

4.3 The second set of amendments removes the requirement that an application for reconsideration for entry to the Pension Protection Fund must include a protected benefits quotation. A protected benefits quotation is a quotation from an insurance provider of the costs of buying an annuity policy to secure scheme member's benefits at the level of compensation they would receive if the scheme transferred to the Pension Protection Fund. As a consequence this instrument amends existing secondary legislation where it refers to this requirement and sets out what alternative information will be required.

5. Territorial Extent and Application

This instrument applies to Great Britain

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

What is being done and why

Amendments to the requirements to obtain actuarial valuations

7.1 The Pension Protection Fund is a statutory fund administered by the Board of the Pension Protection Fund. It protects the pension benefits of members of occupational defined benefit and hybrid schemes e.g. final salary schemes, by paying compensation in place of members' pensions. A scheme enters the Pension Protection Fund if the sponsoring employer has become insolvent after 6 April 2005, and if there are insufficient assets in the pension scheme to cover the level of compensation the Pension Protection Fund would pay to members if it took over the scheme. The scheme's assets and the liability to pay pensions transfer to the Pension Protection Fund. The Pension Protection Fund is funded in part by a levy on eligible schemes.

7.2 Schemes that may be eligible to enter the Pension Protection Fund undergo regular valuations of their assets and liabilities (under section 179 of the Pensions Act 2004) to determine their level of funding. The information from the valuation is indicative of the likelihood of a scheme making a claim on the Pension Protection Fund and is used as part of the calculation of how much annual pension protection levy a scheme must pay.

7.3 In the event that the scheme's sponsoring employer becomes insolvent the scheme will enter an assessment period for entry to the Pension Protection Fund. As part of this process the Board of the Pension Protection are required to obtain a section 143 valuation, undertaken by an actuary, of the scheme's assets and liabilities at the time of insolvency. Producing a valuation includes producing a set of scheme accounts valuing each asset of the scheme, the detailed requirements are set out in The Pension Protection Fund (valuation) 2005 regulations Valuation regulations. If there are insufficient assets in the pension scheme to cover the compensation the Pension Protection Fund would pay, the Board is required to assume responsibility for the scheme.

7.4 Practical experience has shown that in a number of cases, particularly where a scheme is significantly over or under funded at the time of the insolvency, there is already sufficient independent information held about a scheme to allow the funding position to be accurately assessed without requiring a further full actuarial valuation. In particular when the Pension Protection Fund has valuations of the scheme prepared under section 179.

7.5 The changes to primary legislation permit the Board of the Pension Protection Fund to determine the funding position where it is able to do so without obtaining a section 143 valuation.

7.6 The changes will also enable the Board of the Pension Protection Fund to assess a scheme that has been running as a closed scheme (i.e. that no longer has any active members accruing pension benefits) for entry without being required to obtain an actuarial valuation. A scheme may have been authorised to continue running as a closed scheme if, on an employer insolvency, the scheme applied to the Pension Protection Fund but did not transfer into the Fund because the scheme assets exceeded the amount required to pay pensions at compensation levels.

Amendments to requirement to obtain a protected benefits quotation

7.7 The trustees or managers of a scheme that has been refused entry because it was valued as being overfunded for entry can reapply within six months to the Board of the Pension Protection Fund. The Board will assume responsibility for the scheme if it is satisfied that the value of the assets of the scheme at the reconsideration date is less than the amount quoted in the protected benefits quotation plus other scheme liabilities and costs. This amount indicates how much it would cost the scheme to wind up outside of the Pension Protection Fund by purchasing annuities to cover the cost of members' pensions.

7.8 The changes to primary legislation remove the requirement that these applications must be accompanied by a protected benefits quotation. Instead trustees or managers of schemes must provide evidence that they have tried but have been unable to obtain this quotation. The Board of the Pension Protection Fund will then reconsider if there are insufficient assets in the pension scheme to cover the level of compensation the Pension Protection Fund would pay to members if it took over the scheme. As for applications with a protected benefits quotation, the Board may obtain a valuation but is not required to do so.

7.9 The change is being made because in practice the trustees and managers of some schemes have been unable to obtain the required quotation from the insurance market. Then schemes have to run on as closed schemes, increasing the risk on the Fund and leaving members in an uncertain position. When the Pension Protection Fund became operational in 2005 the insurance market was buoyant and schemes did not face the problems they do today in obtaining these quotations.

Consequential amendments to secondary legislation

7.10 This instrument makes the required consequential amendments to the existing secondary legislation governing the detail of how the PPF operates as follows:

7.11 The Multi-Employer Scheme Regulations modify how the provisions in the Pensions Act 2004 governing the Pension Protection Fund apply in the case of a pension scheme that has more than one sponsoring employer. This instrument amends the Multi-Employer Scheme Regulations to permit the Board of the Pension Protection Fund to make a funding determination without requiring a new actuarial valuation for the types of multi-employer scheme which the Board will have section 179 valuations for. Some multi-employer schemes are dealt with by splitting the scheme on an employer insolvency so the Board of the PPF assesses only a part of the scheme for entry. For these schemes the amendments modify the Pensions Act so that the PPF will still be required to obtain a valuation.

7.12 The Pension Protection Fund (Entry Rules) Regulations set out the form and content of applications for schemes that wish to be reconsidered for entry to the Pension Protection Fund. These regulations are amended to require an application that does not include a protected benefits quotation to provide evidence that all reasonable steps have been taken to try and obtain one.

7.13 This instrument also makes changes to Review and Reconsideration Regulations which provide for the review and reconsideration by the Board of the Pension Protection Fund of certain types of decision - ‘reviewable matters’. The amendments to these Regulations specify the time limits for an application for review or reconsideration of a decision by the Board not to obtain a valuation and the issue of a funding determination (which are new ‘reviewable matters’). The regulations are also amended to specify who are the ‘interested persons’ who may apply for a review of each of the new type of ‘reviewable matter’ decisions the Board will be making.

7.14 Similar amendments are made to the Pension Protection Fund Ombudsman Regulations to set the time limits for an applicant to refer an issue with one of the new reviewable matters to the Ombudsman for the Board of the Pension Protection Fund.

7.15 The Valuation Regulations set out the detail of how the assets and liabilities of eligible schemes are to be assessed both for regular section 179 valuations and section 143 valuations as part of the assessment process for entry to the Pension Protection Fund. These regulations are amended to set out how funding determinations are to be carried out. In particular they provide that the Board of the Pension Protection Fund must use information from the most recent section 179 valuation or an appropriate alternative actuarial valuation and update this in accordance with the statement the PPF will issue and the provisions of the regulations. The primary legislation requires the PPF to issue a statement, in line with the provisions of the regulations to set out how they will carry out funding determinations.

7.16 The Provision of Information Regulations sets out the information that trustees or managers of certain occupational pension schemes are required to provide to the members and beneficiaries. They are amended to require Board of the Pension Protection Fund to provide a summary of a funding determination made containing the same information that the members and beneficiaries would have received had a section 143 valuation been obtained from an actuary.

7.17 Finally minor amendments are made to the definition of a “Pension Protection Fund valuation” in the Fraud Compensation Regulations and to the definition of ‘the relevant period’ in the Closed Scheme Regulations.

Consolidation

7.18 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

8.1 As part of the bill process extensive discussion with Stakeholders took place. Feedback from the industry indicated that these changes were sensible and welcome. Given the recent consultation on the primary legislation there is no statutory requirement to consult. The regulatory changes to secondary legislation being made by this instrument are purely consequential and cover technical details in which the pension industry and the Pension Protection Fund have the greatest interest.

8.2 The Pension Protection Fund has advised that if this statutory instrument does not come into force in July 2012 there are a number of schemes that will incur additional costs. These costs would ultimately fall to the PPF if the scheme assets are reduced before these schemes enter the PPF.

There are currently 4 schemes that have been unable to secure a Protected Benefit Quotation within the timeframe required for reconsideration to the Pension Protection Fund. These are schemes that were slightly overfunded when the Board obtained valuations for them at the start of the assessment process but this is up to 3 years ago and the trustees wish to apply for reconsideration as the trustees believe that changes in the markets since mean that their schemes are no longer sufficiently funded to wind up outside of the PPF. The trustees are having difficulty in obtaining a protected benefits quotation, they may only be able to obtain a quote by buying one which would cost approximately £50,000 per scheme. Alternatively a scheme could run on as a closed scheme but this also means increased costs for the scheme (in administration) and the PPF since they will be involved with the scheme for a longer period. If the scheme later enters the PPF there could be higher compensation payable if more scheme members have become pensioners when the scheme enters the PPF (pensioners receive 100% of their pension compared to 90% for deferred members).

On balance the decision was made in this instance to forgo consultation on what are changes of technical detail to the legislation to enable the agreed changes to the primary, and give preference to alleviating the uncertainty and additional costs (approximately £200,000 in total) to schemes and the PPF.

9. Guidance

9.1 The Department for Work and Pensions will be in a position to provide advice on the policy behind the instrument through either written or verbal correspondence. The Board of the Pension Protection Fund will issue a statement setting out how they will make a funding determination when an actuarial valuation is not required once the provisions in the legislation (which the statement will be subject to) are made.

9.2 The Board of the Pension Protection Fund will provide guidance and advice on the operational processes used to implement the changes this instrument introduces. This will be made available on the Pension Protection Fund website: http://www.pensionprotectionfund.org.uk

10. Impact

10.1 The impact on business and civil society organisations is small but beneficial. For those schemes where the Pension Protection Fund is able to make a funding determination, rather than requiring a new actuarial valuation, the decision as to whether the Pension Protection Fund will take responsibility for the scheme will be made more speedily, with both the Pension Protection Fund and the scheme incurring less cost.

10.2 There is no impact on the public sector.

10.3 A full impact assessment has not been prepared for this instrument. However, an assessment of the impact on the introduction of funding determinations was included as part of the impact assessment for the Pensions Act 2011. The relevant extract from that impact assessment is attached to this memorandum; the figures remain up to date.

11. Regulating small business

11.1 This legislation applies to defined benefit and hybrid occupational pension schemes that are sponsored by small business, and the impact on those schemes affected by these changes is beneficial though small.

12. Monitoring & Review

12.1 The outcome of removing the requirement for a section 143 valuation is that the assessment process will be shorter for some schemes meaning that schemes will transfer to the Pension Protection Fund more quickly reducing costs to the scheme and the Fund. We will therefore monitor business gains against a reduction in the average time spent in the PPF assessment

12.2 The Department and the Board of the Pension Protection Fund will review the policy and operational impact of these changes on an ongoing basis as part of the Department's oversight of the Pension Protection Fund's operations.

13. Contact

13.1 Alison Humberstone at the Department for Work and Pensions Tel: 0207 4495132 or email: Caxton.ppf-responses@dwp.gsi.gov.uk can answer any queries regarding the instrument