EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND AND OCCUPATIONAL PENSION SCHEMES (LEVY CEILING AND COMPENSATION CAP) ORDER 2018

2018 No. 39

1. Introduction

1.1 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 Broadly, the Pension Protection Fund (PPF) provides compensation to pension scheme members whose employer has become insolvent and cannot meet scheme liabilities and is funded mainly by a levy collected from pension schemes. This instrument increases two amounts used by the Board of the PPF (the Board). The increases ensure that rises in average earnings are taken into account in setting these two amounts so that they maintain their value. The two amounts are:

- the levy ceiling, which controls the maximum amount of levy the Board can charge pension schemes
- the standard amount of the compensation cap, which helps control PPF expenditure by limiting the amount of compensation payable by the Board.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to the negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 The Secretary of State is required to uprate the levy ceiling annually (section 178(1) of the Pensions Act 2004)[1] in line with the general level of earnings in Great Britain, unless there is no increase in the general level of earnings. Section 178(4) of the Pensions Act 2004 and regulation 3 of S.I. 2006/2692[2] provide that the review period is the period of 12 months ending on 31st July each year.

4.2 The Secretary of State is also required to make an Order under paragraph 26A(7) of that Schedule to specify the standard amount of the compensation cap for the purposes of paragraph 26A(3) and (4) of that Schedule.

[1] https://www.legislation.gov.uk/ukpga/2004/35/contents
[2] http://www.legislation.gov.uk/uksi/2006/2692/made

4.3 Article 4 of the Pension Protection Fund and Occupational Pension Schemes (Levy Ceiling and Compensation Cap) Order 2017[3] (the 2017 Order), made under a power previously contained in paragraph 26(7) of Schedule 7 to the Pensions Act 2004 specified what is effectively a standard amount at which compensation is capped (see sub-paragraph (a) of that paragraph). Paragraph 26A(7)(a) re-enacts the power that was in sub-paragraph (a) of the definition of "the compensation cap" in paragraph 26(7) with modification. Section 17(2) of the Interpretation Act 1978 means that Article 4 of the 2017 Order has effect as if made under paragraph 26A(7)(a).

4.4 Paragraph 27(2) of Schedule 7 to the Pensions Act 2004 requires the Secretary of State to make an Order increasing the amount specified for the purposes of paragraph 26A(7) where he concludes on a review under section 148(2) of the Social Security Administration Act 1992[4] that the general level of earnings in Great Britain has gone up over the period of a tax year. That requirement applies in relation to the amount specified by Article 4 of the 2017 Order and therefore this Order is made by virtue of paragraph 27(2).

4.5 This instrument sets out the new levy ceiling and the level of the standard amount of the compensation cap for the PPF from 1 April 2018.

5. Extent and Territorial Application

5.1 The extent of this instrument is Great Britain.

5.2 The territorial application of this instrument is Great Britain.

5.3 The Department for Communities in Northern Ireland will be introducing its own legislation replicating this Order for Northern Ireland.

6. European Convention on Human Rights

6.1 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

7.1 The Pensions Act 2004 established the Pension Protection Fund (PPF) from 6 April 2005. It 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 pension benefits at least at PPF compensation levels.

7.2 The PPF provides two levels of compensation:

- for members who have reached their scheme's normal pension age or, irrespective of age, are either already in receipt of a survivor's pension or a pension on the grounds of ill health, the Board will pay compensation at 100 per cent of the pension due at the assessment date (date at the start of the procedure by which the Board assesses whether the scheme can enter the PPF)

[3] http://www.legislation.gov.uk/uksi/2017/50/contents/made

[4] http://www.legislation.gov.uk/ukpga/1992/5/contents/enacted

- for members below their scheme's normal pension age, the Board will pay compensation at 90 per cent of the pension accrued at the assessment date, subject to an overall cap.

7.3 The Pension Protection Fund (PPF) is funded by:

- the pension protection levy that is charged to eligible defined benefit occupational pension schemes
- the remaining assets of schemes that enter the PPF
- funds recovered from insolvent employers
- investment returns on the PPF's assets.

7.4 The pension protection levy is comprised of a risk-based levy which is required by law to be at least 80 per cent of the total, with a scheme-based levy making up the remainder. The scheme-based levy is calculated using the level of a scheme's liabilities and the risk-based levy is calculated using the level of a scheme's underfunding and the likelihood of employer insolvency for that scheme.

7.5 Each year the Board is required to estimate the total amount of the pension protection levy it will collect. The levy ceiling prevents the Board from imposing a total levy in excess of the amount specified by this instrument. The ceiling is set at a level that is sufficient to allow the Board to raise a levy that ensures the safe funding of the compensation it provides, whilst providing reassurance to schemes that the levy estimate will not be above a certain amount in any one year.

7.6 This instrument specifies that the increase in the general level of earnings for the year ending on 31 July 2017 is 1.7 per cent over the previous year. Therefore the amount of the levy ceiling for the financial year beginning on 1 April 2018 is £1,024,372,330. The new levy ceiling has been calculated by increasing the current levy ceiling (£1,007,249,095) by this 1.7 per cent.

7.7 The compensation cap limits the compensation that can be paid by the Board to a single member under the normal pension age of the scheme at the assessment date and who is not in a receipt of a survivor's or admissible ill health pension. The standard amount of the compensation cap is set by the Secretary of State and compensation to affected members will normally be limited to a maximum of 90 percent of the cap.

7.8 The cap is intended to limit costs in the PPF and to deter excessive risk taking and malpractice by, for example company directors, whereby decisions could be taken that result in the insolvency of the company, in the knowledge that their pension benefits and those in respect of their colleagues would in effect be insured by the PPF. This is a common feature of insurance and financial compensation or assistance schemes.

7.9 The Secretary of State is required to make an Order to set out the standard amount of the compensation cap. The Secretary of State is required where he concludes that the general level of earnings in Great Britain has gone up over the period of a tax year (on a review under section 148(2) of the Social Security Administration Act 1992)[5] to make an Order increasing the standard amount by the same percentage.

7.10 The Secretary of State has reviewed the general level of earnings in Great Britain. He concluded that the general level of earnings for the period from April 2016 to April

[5] http://www.legislation.gov.uk/ukpga/1992/5/section/148/enacted

2017 (i.e. the 2016/17 tax year) exceeded the general level of earnings at the end of the 2015/16 tax year.

7.11 Average earnings increased by 1.3 per cent in the 2016/17 tax year. That percentage is applied to the current standard amount of the compensation cap (£38,505.61) to provide an uprated standard amount of the cap of £39,006.18 from 1 April 2018. When applying the 90 per cent provision to that uprated standard amount it will provide, at age 65, a maximum level of compensation of £35,105.56.

7.12 For the purposes of this Order, the Secretary of State has made two measurements of the general level of earnings using the Average Weekly Earnings (AWE) estimates, produced by the Office of National Statistics[6], which is the lead measure of earnings growth in Great Britain. Each estimate represents the year on year growth rate for the specified time period; it is not seasonally adjusted but includes bonuses and arrears. The period of time set out in the legislation differs slightly for each measure which is why two different percentage figures are used.

Consolidation

7.13 As this instrument does not amend other legislation, consolidation is not applicable. Informal consolidated text of instruments is available to the public free of charge via ‘the National Archives’ website[7].

8. Consultation outcome

8.1 Consultation was not considered necessary as this instrument simply enables routine annual uprating.

9. Guidance

9.1 No guidance is being issued on this instrument since it is largely based on existing legislation. The Department for Work and Pensions (DWP) will have copies of the instrument and be in a position to explain it to members of the public.

10. Impact

10.1 There is no new direct impact on business, charities or voluntary bodies, as this instrument amends the existing regulatory regime by a pre-determined formula in line with statutory requirements.

10.2 This instrument has no impact on the public sector.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation does not apply to activities that are undertaken by small businesses.

12. Monitoring & review

12.1 This Order is monitored by DWP and the Board of the Pension Protection Fund and reviewed every 12 months.

[6] https://www.ons.gov.uk/
[7] http://www.legislation.gov.uk

13. Contact

13.1 Daniel Tinker at the Department for Work and Pensions, Telephone: 01132 327 785 or email: Daniel.Tinker@dwp.gsi.gov.uk can answer any queries regarding the instrument.