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Pension Protection Fund

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Summary

The Pension Protection Fund (PPF) was one of the measures set up by the *Pensions Act 2004* in response to a series of high-profile cases in which pension schemes had wound up with insufficient assets to meet their pension commitments. It was established to pay compensation to members of defined benefit and hybrid occupational pension schemes where an employer has become insolvent, and where there are insufficient assets in the pension scheme to cover PPF levels of compensation. It commenced operations on 6 April 2005 and applies to schemes whose sponsoring employer became insolvent after that date.

The PPF provides two levels of compensation: in broad terms -100% to people who have reached their scheme's normal pension age or are in receipt of an ill-health or survivors' pension at the time the scheme enters the PPF assessment period and, in other cases, 90% subject to a cap. There are other ways in which PPF compensation does not necessarily match what would have been provided by the pension scheme had not wound up. For example, indexation is only provided on compensation based on rights accrued from April 1997.

Legal challenges to compensation levels

The European Court of Justice (CJEU) delivered its judgement in the Hampshire case in September 2018. It concluded that Article 8 of the Insolvency Directive 2008/94/EC requires that an individual's expected old-age pension benefits must be protected to a minimum level of 50% in the event of employer insolvency.

In response to the judgment, the PPF said that there would be a small number of PPF and FAS members affected by the judgement: the vast majority already received more than 50% of the value of their accrued benefits. Pending legislation to implement the ruling, it put in place arrangements that it said would ensure those most affected received an appropriate increase. It has produced FAQs to explain the impact.

In May 2020, the High Court heard a challenge against way the way the PPF was implementing the Hampshire ruling and to the lawfulness of the cap. On 22 June, it ruled in Hughes v PPF that the compensation cap was unlawful on grounds of age discrimination. It said the approach the PPF was taking to implement the Hampshire ruling was permissible, provided that over the course of their lifetime each individual, and separately each survivor, received at least 50% on a cumulative basis of the actual value of the benefits that their scheme would have provided.

On 20 August, the PPF said it had lodged an appeal against the requirement set by this judgement to make sure that members and survivors each received at least 50% on a cumulative basis of the actual value of the benefits their scheme would have provided. It said this would require it to amend its methodology and was different to its view of what the Insolvency Directive required. In addition, DWP is seeking permission to appeal the judgement that the compensation cap is age discriminatory.

Measures in the *Pension Schemes Bill 2019/21 (s126)* are intended to ensure the PPF can continue to operate as intended, following the decision of the High Court in the Beaton case, which the Government was concerned was being interpreted in ways that had potential for perverse and unintended outcomes (Bill 165-EN, para 665-69).

Funding the PPF

The PPF is funded by a combination of:

- The assets transferred from schemes for which it has assumed responsibility;
- Recoveries of money, and other assets, from those schemes' insolvent employers;
- An annual levy raised from eligible pension schemes; and
- Investment returns on assets held by the PPF.

The pension protection levy is comprised of a risk-based levy (required by law to be at least 80 per cent of the total) and a scheme-based levy, making up the remainder.

The Secretary of State is required to set a levy ceiling each year, at a level "sufficient to allow the Board of the PPF to raise a levy that ensures the safe funding of the compensation it provides, whilst providing reassurance to business that the levy will not be above a certain amount in any one year." The ceiling is increased each year in line with earnings and can be increased by more if the Board makes a recommendation to that effect and the Treasury approves. Once the PPF has set its estimate, it uses a "scaling factor" to distribute the levy proportionately among eligible schemes. The PPF aims to keep the levy stable for three years. On 16 December 2019, it confirmed that its levy rules for 2020/21 would remain "stable and broadly unchanged from previous levy year." Its levy estimate for 2020/21 was £620 million (PPF confirms levy rules for 2020/21).

The PPF has a target of becoming self-sufficient by 2030. This is because it expects there to be fewer claims from schemes on the PPF in future and that the "the levy we need to collect will be small in comparison to our own assets and liabilities." At this point, it will need to have confidence that it is holding enough money to pay compensation to members and protect them adequately from the risk of adverse conditions thereafter. (PPF Strategic Plan 2019/22). Its 2020 Annual Report, the PPF said the probability of success in relation to this target had fallen from 89% to 83% over the year to March 2020 but that this still indicated "a good level of confidence" that it remained on track to meet it.

This note provides an overview how the PPF works and current debates. More background is in Library Briefing Paper, SN 2779 Pension Protection Fund 1993-2003 and 04/18 on the Pensions Bill 2003/04.

1. Background

Defined Benefit (DB) schemes provide pension benefits based on fixed factors – typically salary and length of service. From the point of view of members, the critical point is that they know what pension they will eventually get.

In the early years of the 21st century, there were a number of high-profile cases where schemes wound up with insufficient assets to meet their pension commitments, leaving members facing dramatic shortfalls in their pension.[1]

1.1 *Pensions Act 2004*

In response, the Labour Government legislated in the *Pensions Act 2004* to establish a Pension Protection Fund to pay compensation to members of DB schemes where an employer has become insolvent, and where there are insufficient assets in the pension scheme to cover PPF levels of compensation.[2] In a statement to Parliament in June 2003, the then Secretary of State for Work and Pensions, Andrew Smith, set out the rationale for this as follows:

> […] if people expect their holiday provider or motor insurer to be covered if the firm goes bust, there is no cover for something as important as an occupational pension. We will therefore legislate to set up a pension protection fund. That fund will take over the schemes of insolvent companies to ensure not only that pensions in payment are protected, but that those still working can be sure of getting 90 per cent of what they were promised. It will be paid for by a fixed-rate levy and an additional risk-related premium, which, together with a salary cap, will minimise perverse incentives and moral hazard. The fund will be a non-Government body. It will meet its obligations through the power to set and vary the level of charge without recourse to public funds. Taken with the other measures, that is a big extension of pension security, for the first time guaranteeing protection if a company scheme goes bust.[3]

Other pension protection measures introduced in the same legislation, included:

- Replacing the Minimum Funding Requirement – which had been criticised for "distorting investment decisions without providing effective protection for members" - with new scheme-specific funding requirements – see Library Briefing Paper CBP-04877 Defined benefit pension scheme funding (October 2019).

- Strengthening the regulatory framework through the introduction of a new Pensions Regulator, with the objective of protecting the benefits of members of work-based pension schemes and reducing the risk of situations arising that may lead to claims for compensation from the Pension Protection Fund.[4] See Library Briefing Paper CBP-04368 The Pensions Regulator – powers to protect pension benefits (July 2020).

- Changes to the 'priority order' for distributing remaining funds when a scheme winds up. For more detail, see SN-03399 *Winding up a pension scheme* (January 2006).

[1] For more detail, see Standard Note, SN 2779 Pension Protection Fund 1993-2003 and in Library Research Paper 04/18 on the Pensions Bill 2003/04.

[2] Pension Protection Fund, *Annual Report and Accounts 2008/09*, HC 1084; For further information on the Fraud Compensation Fund, see SN/BT/2691, '*Pensions: Fraud Compensation Fund*'

[3] HC Deb, 11 June 2003, cc683-684

[4] Pensions Act 2004, s5; The Pensions Regulator – about us

1.2 Framework for the PPF

The Pension Protection Fund is a statutory fund run by the Board of the Pension Protection Fund, a statutory corporation.[5] The rules applying to the PPF are in Part 2 of *Pensions Act 2004* and the regulations made under it.[6] Amendments since 2004 include:

- The *Pensions Act 2008* provided for PPF compensation to be shared on divorce.[7]
- The *Pensions Act 2011* made some changes in the light of experience.[8]
- The *Pensions Act 2014* provided for an enhanced "long service compensation cap."[9]
- Section 126 of the *Pension Schemes Bill 2019-21* would restore the policy intent following the High Court judgment in the Beaton case regarding the treatment of transfers-in.

There is a framework document and a memorandum of understanding between the PPF, TPR and DWP.

1.3 Eligibility

Section 126 of the 2004 Act provides that a scheme is "eligible" for the PPF if it is "not a money purchase scheme" (where contributions are paid into a fund, which is invested and can then be drawn down or used to buy an income at retirement).

This means that the PPF covers defined benefit (DB) schemes (which promise benefits based on salary and length of service) and the DB elements of hybrid schemes, with some exceptions set out in regulations – such as public service pension schemes and schemes with a 'Crown Guarantee.'[10] Members of DB schemes that started to wind up before April 2005 are eligible for the Financial Assistance Scheme (FAS).[11]

For a scheme to enter the PPF the following criteria must be satisfied:

a) the scheme must be a scheme which is eligible for the Pension Protection Fund;

b) the scheme must not have commenced wind up before 6 April 2005;

c) an insolvency event must have occurred in relation to the scheme's employer which is a qualifying insolvency event;

d) there must be no chance that the scheme can be rescued; and

e) there must be insufficient assets in the scheme to secure benefits on wind up that are at least equal to the compensation that the Pension Protection Fund would pay if it assumed responsibility for the scheme.[12]

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5 *Pensions Act 2004,* Section 107
6 For example, *Pension Protection Fund (Compensation) Regulations 2005 (SI 2005/670)*; *Pension Protection Fund (Entry Rules) Regulations 2005 (SI 2005/590)*
7 Part 3. The background to these changes is discussed in Library Research Paper 07/94 – Pensions Bill
8 Pensions Bill 2011 – Impacts – Annex D: Pension Protection Measures; Library Research Paper 11/52 Pensions Bill
9 See Library Briefing Paper SN-06846 Pensions Bill 2013/14 – House of Lords stages (March 2014)
10 *Pensions Act 2004* (s126) *Pension Protection Fund (Entry Rules) Regulations 2005 (SI 2005/590)*; Pension Protection Fund website – About us - eligibility
11 *Pensions Act 2004,* s286; The *Pensions Act 2008, s124* provided for some schemes caught between the PPF and the FAS to enter the FAS - see HL Deb, 14 July 2008, c1070 and SI (2008/3068)
12 The rules are in the *Pensions Act 2004* (chapter 3) and the *Pension Protection Fund (Entry Rules) Regulations 2005* (SI 2005/590); PPF website – Eligibility

Trigger for entering an assessment period

The trigger for a scheme entering a PPF assessment period is generally that an insolvency practitioner notifies the PPF that "qualifying insolvency event" has occurred in relation to the employer of an eligible scheme.[13]

The definition of insolvency event under section 121 of the 2004 Act is consistent with those in the *Insolvency Act 1986*. The insolvency events vary depending on whether an employer is an individual, a company or a partnership. Most formal insolvency proceedings are covered, with the exception of members' voluntary liquidation (which is a solvent form of liquidation and therefore not appropriate for compensation).[14] (There is provision for relevant schemes whose sponsoring employer cannot have an insolvency event to be able to enter the Pension Protection Fund.)[15]

However, there are cases where an employer facing insolvency has a deficit and will propose a rescue or restructuring package which will allow the employer to continue trading with the PPF taking on the scheme. It can only take part in restructuring or rescue if the proposal meets specific criteria. PPF guidance explains that:

> The restructuring will mean that the employer's pension scheme will be better off than if the business had been simply left to fail. It usually involves removing the pension debt from the employer company, allowing it to continue to trade with a positive cash flow and potentially make a profit. It is usually achieved through either a Regulated Apportionment Arrangement (RAA) or through a Company Voluntary Arrangement (CVA).
>
> This could be considered to be 'pensions dumping', which would be contrary to the *Pensions Act 2004*, but that is not the case. We will only take part in a restructuring if our principles are met. These principles apply to the consideration of all proposals to ensure there is no selective advantage. These principles are designed to make sure that we only consider restructurings for pension schemes that will come to the PPF in any event and the scheme will be in a much better position than it would have been if we had done nothing. Most negotiations will take place alongside The Pensions Regulator (TPR), which also needs to provide clearance for the transaction before any restructuring can be concluded. Where CVAs are proposed that do not involve the pension scheme being compromised, the PPF has some different considerations which are set out in our PPF Restructuring & Insolvency Team – Guidance Note 5.[16]

Purpose of assessment period

The purpose of an assessment period is to determine whether the PPF should accept responsibility for the scheme. The PPF explains:

> We work with the scheme's advisers during the assessment process, which can last up to two years, to investigate two key questions:
>
> - Can the pension scheme be rescued?
> - Can the pension scheme afford to secure benefits which are at least equal to the pensions we can pay?
>
> If the answer to either of these questions is 'no', and the relevant processes have been completed, the scheme members will be transferred to us.
>
> If the answer is 'yes', the scheme will either continue or wind-up without our involvement.[17]

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13 *Pensions Act 2004*, s120-1. For where an employer cannot technically become insolvent, see s128
14 PPF website – insolvency events
15 *Pensions Act 2004,* s128; SI 2016/294
16 PPF, Guidance on the PPF's approach to employer restructuring; PPF website – Guidance on restructuring; For more context, see Commons Library Briefing Paper CBP 4368, July 2020
17 PPF website, An overview of the assessment process

During an assessment period, trustees remain responsible for paying pensions, which must be paid at PPF compensation levels.[18]

During the process, the PPF takes over the role of creditor of the scheme: representing the scheme at any creditor meetings, negotiating with relevant stakeholders and serving any debt. Ultimately the PPF only takes responsibility for the scheme if it cannot otherwise be rescued and cannot afford to secure benefits which are at least equal to PPF compensation levels. If it can do either of these things, the scheme will either continue or wind up without its involvement.[19] More detail is in PPF guidance on insolvency and the assessment period.

New regulations introduced in 2020 enable the PPF, in specified circumstances, to exercise creditor rights in relation to new insolvency measures introduced under the *Corporate Insolvency and Governance Act 2020.* These new measures, which in some ways represents a shift toward a business rescue culture more in line with U.S. insolvency (chapter 11), are:

- A restructuring plan to help viable companies struggling with debt obligations; and
- A free-standing moratorium for UK companies to give companies a formal "breathing space" in which to pursue a rescue or restructuring plan.[20]

The regulations were needed because neither process counted as a 'qualifying insolvency events', which would normally trigger the start of an assessment period (and the PPF's involvement).[21]

There is an overview of what happens in an assessment period on the PPF website and a more detailed account in PPF's Trustee Good Practice Guide.

1.4 Numbers

The table below shows the number of pension schemes that went into a PPF assessment period between April 2015 and October 2020 and, of these, how many have been transferred into the PPF or been withdrawn from the PPF process.

[18] *Pensions Act 2004,* s138; PPF website – the role of trustees during assessment

[19] PPF website, An overview of the assessment process; The role of trustees during assessment

[20] New Business Support Measures: Corporate Governance and Insolvency Act 2020., Commons Library Briefing Paper, CBP 8971 , Oct 2020

[21] *Corporate Insolvency and Governance Act 2020,* sA51 *Pension Protection Fund (Moratorium and Arrangements and Reconstructions for Companies in Financial Difficulty) Regulations 2022 (SI 2020/683); The Pension Protection Fund (Moratorium and Arrangements and Reconstructions for Companies in Financial Difficulty) (Amendment and Revocation) Regulations 2020 (SI 2020/990);* Explanatory Memorandum to SI 2020/990, para 7.4-5

Schemes that have entered Pension Protection Fund (PPF) assessment

Financial year	Schemes entering PPF assessment: total (a)	of which: Schemes transferred into PPF		Schemes withdrawn from assessment		Still in assessment in Oct 2020
	by assessment date	by assessment date	by transfer date	by assessment date	by withdrawal date	by assessment date
2005/06	122	105	-	16	1	1
2006/07	131	97	9	18		16
2007/08	101	89	33	11	6	1
2008/09	128	115	59	13	6	
2009/10	107	100	50	7	15	
2010/11	128	111	134	17	18	
2011/12	86	81	150	5	16	
2012/13	96	85	143	5	15	6
2013/14	80	69	122	11	6	
2014/15	48	39	96	5	10	4
2015/16	41	31	33	7	3	3
2016/17	46	39	62	5	11	2
2017/18	52	34	46	9	5	9
2018/19	34	20	37	8	16	6
2019/20	48	5	36	4	8	39
Apr-Oct 2020	33	1	11	1	6	31
Total	**1,281**	**1,021**	**1,021**	**142**	**142**	**118**

Note (a) For multi-sponsor schemes, each scheme section is counted separately.

Source Pension Protection Fund website: Pension schemes we look after. Accessed 27 October 2020.

The size of the schemes entering the PPF is also important. Large schemes which have transferred to the PPF, or entered a PPF assessment period, include:

- **2007**: the **MG Rover Group Pension Scheme,** with 6,000 members, transfers
- **2012**: the **UK Coal Pension Scheme** transfers
- **2016:** the **BHS pension schemes** come into assessment
- **2017**: the **British Steel Pension Scheme** comes into assessment
- **2018**: **Carillion, Hoover** and **Toys 'R' Us** all enter assessment;
- **2019**: **Thomas Cook** and **Kodak Pension Plan No 2** (which, with 11,000 members, is the largest claim on the PPF to date) come into assessment.[22]
- In **January 2020**, the Carillion Rail (GTRM) Pension Scheme (with 4,000 members) became the 1,000th to transfer to the PPF.[23]

Details of the schemes in assessment and those that have transferred to the PPF are on its website – pension schemes we look after.

[22] PPF website, key moments in its history; PPF Annual Report and Accounts 2018/19, p17
[23] PPF Annual Report and Accounts 2020/21, p28

As at March 2020, the PPF had 276,580 members and £36.1 billion in assets under management. In 2019/20, it paid £860 million in benefits to members. [24]

Its actuarial balance sheet comprises the assets and liabilities of schemes that have already transferred in, plus provisions in respect of schemes which at the valuation date are expected to enter the PPF in due course. This shows that the PPF had reserves of £5.1 billion at the end of March 2020 and a funding ratio of 113.4% (meaning that the Fund's assets provide 113.4% coverage of its liabilities).

Pension Protection Fund actuarial balance sheet and membership

	PPF actuarial balance sheet [a]				PPF membership at year end	
	Assets	Liabilities	Surplus (deficit) [b]	Funding ratio [c]	Deferred members	Pensioners
	£m	£m	£m	%	number	number
2005/06	2,086	2,429	(343)	85.9%	..	..
2006/07	4,416	5,025	(609)	87.9%	5,621	1,457
2007/08	5,554	6,071	(517)	91.5%	8,577	3,596
2008/09	9,330	10,560	(1,230)	88.4%	18,009	12,723
2009/10	12,257	11,863	394	103.3%	25,428	20,775
2010/11	14,043	13,366	678	105.1%	42,063	33,069
2011/12	16,513	15,444	1,069	106.9%	70,608	57,506
2012/13	20,098	18,346	1,753	109.6%	91,353	80,665
2013/14	21,751	19,328	2,424	112.5%	100,070	95,599
2014/15	27,627	23,998	3,629	115.1%	109,102	112,392
2015/16	29,004	24,948	4,056	116.3%	107,831	119,442
2016/17	34,122	28,059	6,062	121.6%	109,645	128,793
2017/18	36,297	29,551	6,746	122.8%	107,587	134,979
2018/19	38,645	32,589	6,057	118.6%	109,567	148,005
2019/20	42,875	37,810	5,065	113.4%	116,461	169,861

Note (a) Includes assets and liabilities in respect of schemes transferred in, plus provisions and contingent liabilities requiring actuarial estimation. (b) Assets minus liabilities. (c) Assets as percentage of liabilities.

Source PPF annual report and accounts, various editions.

See section 3.2 of this note for more on the PPF's funding status.

[24] PPF Annual Report and Accounts 2019/20, p16-7

2. PPF compensation

2.1 Indexation

PPF compensation payments are increased in line with prices capped at 2.5%, but only in respect of compensation based on rights accrued from April 1997.[25]

This reflects the fact that before April 1997 there was no general obligation on occupational pension schemes to increase pensions in payment.[26] The *Pensions Act 1995* introduced a requirement to increase pensions in payment by the lower of the Retail Price Index (RPI) or 5%, on rights accrued since April 1997. *Pensions Act 2004* reduced the cap from 5% to 2.5% for rights accrued in defined benefit schemes from 6 April 2005.[27]

When the *Pensions Bill 2003/04* was before Parliament, the then Pensions Minister, the late Malcolm Wicks explained the Government's view that, in principle, the PPF should not provide more generous benefits than pension schemes themselves:

> The PPF is being set up to provide adequate protection for individuals who face losing some or all of their pension entitlements, not to provide a level of compensation that would attempt to match the level of scheme benefits, or even offer more. Providing indexation increases prior to 1997 could result in some members receiving a level of PPF compensation in excess of the level that would have been provided from their scheme. However, I stress that the PPF seeks to provide a consistent and meaningful level of compensation for all members eligible for fund assistance. Restricting the amount of indexation paid on PPF compensation would ensure that the PPF could do that, by being better able to predict its liabilities and plan ahead financially.[28]….

He estimated that providing more generous indexation arrangements would also have cost implications, of around £200 million.[29]

In June 2018, the Government said it had no plans to change the rules:

> The Labour government set up the Pension Protection Fund (PPF) to pay a meaningful level of compensation to DB scheme members where the sponsoring employer becomes insolvent. The PPF is fundamentally funded by a levy on eligible schemes. Therefore, any decision to increase either the level of compensation, or to provide inflation increases to pensions built up before April 1997, would result in significant increases to levy payers. It is not proposed to change the present law.[30]

In October 2019, it said it would be inappropriate to comment further in the light of ongoing court cases relating to the Pension Protection Fund compensation (see below). It would review the position once the litigation was concluded.[31]

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25 *Pensions Act 2004*, Sch 7, para 28
26 IDS Pension Service, *Pension scheme design,* March 2006, para 3.37
27 Section 278 and *Commencement Order No 2*, SI 2005/275
28 SC Deb, 30 March 2004, c512
29 Ibid, c513
30 PQ 147874 4 June 2018
31 PQ 267 14 October 2019

Switch to the CPI

The *Pensions Act 2004* originally provided for pension compensation to be increased in line with the Retail Prices Index (RPI).[32] In July 2010, the Government announced its intention to switch from the RPI to the Consumer Prices Index (CPI) for determining increases in occupational pensions and PPF and FAS compensation payments. The reason was that:

> The Government believe the CPI provides a more appropriate measure of pension recipients' inflation experiences and is also consistent with the measure of inflation used by the Bank of England.[33]

This was provided for in *Pensions Act 2011* (s20).[34] When this provision was before Parliament, the then Pensions Minister, Steve Webb, explained that the PPF was "essentially, a safety net scheme", not intended to provide exactly what the scheme would have provided. The impact would "vary hugely between individuals."[35]

2.2 Two levels of compensation

The PPF provides two levels of compensation – in broad terms -100% to people who have reached their scheme's normal pension age or are in receipt of an ill-health or survivors' pension at the time the scheme enters the PPF assessment period and, in other cases, 90% subject to a cap.[36] Its website explains:

> As a member of the PPF, you'll receive pension benefits from us rather than a pension from your former scheme. You'll hear us call your payments 'benefits' or sometimes 'compensation' as we're paying you compensation for the pension that you've lost.
>
> **How much will you receive from us?**
>
> The level of benefits you'll receive from us is dependent on whether you had passed your normal pension age on the date your employer became insolvent. Your normal pension age is the age at which you are entitled to take your pension without facing any reductions according the rules of your former scheme.
>
> **Already passed your normal pension age?**
>
> If you had already passed your normal pension age when your employer became insolvent, or if you had retired through ill-health, you will receive a pension equal to 100 per cent of your scheme pension on the insolvency date. This also applies if you're receiving pension benefits you had inherited from someone who died before their employer became insolvent.
>
> **If you've not yet reached your normal pension age**
>
> If you hadn't reached your scheme's normal pension age when your employer became insolvent you will see a reduction in your payments to 90 per cent of your scheme pension on the insolvency date.
>
> Your compensation may also be subject to a statutory limit known as the compensation cap. You can find out more about the compensation cap by downloading our compensation cap factsheet.
>
> **Will my pension payments increase?**
>
> In most cases, when we start to make payments to you, your payments relating to pensionable service from 6 April 1997 will rise in line with inflation each year, subject to a maximum of 2.5 per cent a year. Payments relating to pensionable service before that date won't increase.

32 *Pensions Act 2004*, s Sch 7, para 28
33 HC Deb 8 July 2010 c15WS
34 *Pensions Act 2011* (s20)
35 PBC Deb, 14 July 2011 (afternoon), c317-8
36 *Pensions Act 2004*, Sch 7

> Sometimes there won't be a rise in inflation and so your payments won't increase. Sometimes inflation will fall but, if it does, your payments won't be reduced.[37]

More detailed information is in booklets on the PPF Members' website.

2.3 The compensation cap

For most of those below normal pension age when their scheme enters a PPF assessment period, the PPF will pay a 90% level of compensation, subject to a cap.[38] The cap is increased each year in line with earnings. In April 2020, it increased to £41,461.07 at age 65. When applying the 90 per cent provision to this, this means a maximum level of compensation of £37,314.96 at age 65.[39] The enhanced cap for long service is discussed below.

The original rationale behind the cap was to limit PPF expenditure and to provide an incentive for higher earners, who might have influence over the management of a defined benefit scheme, to ensure that a scheme remains out of the PPF if possible.[40] When the legislation was before Parliament, the then Shadow Pensions Minister, Nigel Waterson, questioned the discrepancy in treatment of those under and over normal pension age: He noted that a number of organisations had suggested putting "pensioners" and "non-pensioners" on the same footing.[41] In response, the then Pensions Minister, the late Malcolm Wicks, said:

> The PPF is a unique institution [...] It is a compensation scheme to ensure people that their pension rights will be safeguarded. Exactly what their pension rights are, and whether they are high enough and so on, is something that we are discussing [...]
>
> Let me explain why we do not favour paying everyone 100 per cent. In an ideal world we would have liked to pay everybody exactly what they were expecting from their scheme, but sadly we cannot do that. In the real world, employers have to bear the cost of the PPF and there are moral hazard issues, which we would be foolish to ignore [...].[42]

In response to further questioning, he added that a balance needed to be struck and that both pensioners and non-pensioners were likely to be better off than if no PPF were established:

> In terms of the famous cliff edge, I can see the letters coming in now—and I understand why—from people close to retirement age and to the 100 per cent. I hope that when they write those letters to the then Minister with responsibility for pensions they will reflect that if we had not got the PPF the figure might have been 30 per cent. That is the alternative. I hope that we shall all keep reminding ourselves of that. We might think that 90 per cent. or 100 per cent. is right, but both of them are better than 30 per cent.[43]

In debate in the House or Lords on 4 March 2020, Work and Pensions Minister Baroness Scott said the Government's view was that the cap met important objectives and should be retained:

> First, the cap helps to give greater protection to those who have reached their scheme's normal retirement age at the time of employer insolvency. These members are likely to have fewer opportunities to supplement their income in other ways. Secondly, the cap helps to control the costs of the fund—costs that may otherwise fall on levy payers. Finally, as we have heard, the cap is intended to encourage people with influence over the schemes to fund them responsibly and to discourage excessive risk-taking. Key decision-makers have an incentive to ensure that their

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37 What being a PPF member means
38 PPF website - compensation
39 SI 2019/159, para 7.12
40 Explanatory Memorandum to SI 2012/528, para 7.3; For more detail, see Library Briefing Paper SN-03917 Pension Protection Fund (July 2012)
41 Pensions Bill Committee Deb, 30 March 2004, c477
42 Ibid, c486
43 Ibid, c487

> schemes stay out of the Pension Protection Fund because the cap is likely to have a direct impact on the compensation that they would receive.
>
> The level of the cap was set after much research and analysis. The current full amount is around £40,000 at the age of 65. Members under their scheme's normal pension age initially receive 90% of the capped amount, which equates to around £36,000 at the age of 65. Nevertheless, this far exceeds the estimated average defined benefit pension of around £8,000. Only a few members of the Pension Protection Fund are affected by the cap. The nature of the cap means that it affects predominantly high earners; abolishing it would, therefore, mainly benefit those high earners.[44]

Some 600 PPF members have their compensation capped.[45]

DWP has lodged an appeal against the judgement of the High Court on 22 June 2020 that the compensation cap was unlawful on age discrimination grounds (see below).[46]

Long-serving scheme members

On1 July 2013, the then Pensions Minister, Steve Webb, announced that he intended to change the rules to enable those with service of more than 20 years with a firm to get an enhanced level of PPF compensation. This was because the cap – which was intended partly as a cost-control measure and partly to prevent moral hazard – had a disproportionate effect on scheme members with long service:

> The original thinking behind that cap was partly as a cost-control measure and partly to prevent moral hazard. The argument there was that if the rules stated that anybody who was drawing a pension would get that in full, even after an insolvency event, and the people who had not started to draw a pension would have to make do with what was left in the fund, there might be an incentive for those in the know at the top of a firm close to insolvency to retire and draw their pension before scheme pension age [...] However, one of its consequences was a disproportionate effect on those with long service and, in a debate in Westminster Hall on the Visteon pension scheme for former Ford workers in December 2012, I announced that we were looking at the operation of the cap.[47]

The law would change to increase the cap by 3% for each full membership year above 20:

> It brings in a new compensation cap, which essentially will be based on an enhanced level for people who have served for more than 20 years. There is a figure for the cap which can be actuarially reduced for people who take early retirement. That will be increased and we envisage this to be by 3% for each year of service beyond 20. It is very much focused on those who have relatively high pensions. We are not talking about people on very low pensions, but about people who have worked for a firm for a long period and who have expectations about their pensions. [48]

The impact assessment explained that the change would increase PPF's liabilities and thereby lead to an increase in the PPF levy:

> […] on the assumption that the costs of the higher cap will be passed on in full to levy payers, it is estimated that the present value of increased levy payments over the period to 2030 will be £139.3 million, although there are significant uncertainties around this.[49]

There was uncertainty about the extent of the increase because some of the costs would be otherwise absorbed:

> As described, the PPF is partly funded by way of a levy on schemes. We have assumed that an increase in the PPF liability will be fully reflected by an increase in the levy. However,

44 HL Deb 4 March 2020 c313
45 Compensation cap on lifeboat scheme ruled unlawful, FT, 22 June 2020
46 Paul Hughes & Others v Board of the PPF & Secretary of State for Work and Pensions. 20-20 Trustees Services Ltd & Ors (interested parties) (2020) - [2020] EWHC 1598 (Admin)
47 PBC Deb 11 July 2013 c422-3
48 HC Deb 1 July 2013 c604; DEP 2013-1146, July 2013 ; *Pensions Act 2014* - Impact Assessment,May 2014
49 Pensions Bill 2013-14 – summary of impacts (May 2014), page 35

> caution should be exercised here, as when setting the levy, the Board of the PPF take into account a large range of different factors that exist at the time the levy is set (such as the risk of schemes entering the PPF, the level of funding if that event occurs, anticipated investment return) only one of which will be its liabilities. Thus, the estimated costs and benefits in this Impact Assessment are also highly sensitive to this assumption. Should investment return improve and/or the number of company insolvencies reduce, then some of these costs could be absorbed.[50]

Three per cent was chosen as the escalation amount on the basis that the Government believed it was "sufficient to lift a substantial number of the target group out of the compensation cap entirely, while still being affordable for the taxpayer."[51]

There was some delay in issuing detailed proposals.[52] However, on 15 September 2016, the Government launched a consultation on the draft regulations needed to insure the long service cap would operate as intended. It explained that those already in receipt of compensation would have their entitlement re-determined but any increase in entitlement apply from April 2017, with no backdating:

> 8. Anyone who is entitled to PPF compensation when the legislation comes into force and who has, or is deemed to have, pensionable service of more than 20 full years (ie. 21 years or more) will have their entitlement redetermined. The three per cent uplift will be applied to the cap which was originally applied to that person's compensation with effect from the date that the legislation comes into force. (Paragraph 8(2) of Schedule 20 to the Pensions Act 2014.) [...]
>
> 10. Increased entitlement will not be backdated. The increase will begin from the date the legislation is brought into force, which is planned for 6 April 2017.[53]

The PPF 'long service cap' came into force from 6 April 2017 under the *Pension Protection Fund (Modification) (Amendment) Regulations 2017 (SI 2017/324)*.

In 2017, the Government consulted on proposals for a similar long service cap in the FAS.[54] Regulations to implement this came into force on 21 February 2018.[55]

2.4 Legal challenges to PPF compensation level

Hampshire

Then, in September 2018, the judgement of the European Court of Justice (CJEU) in the case of Grenville Hampshire v Board of the Pension Protection Fund provided that individuals were entitled to receive compensation to at least 50% of their pension entitlements.[56] Mr Hampshire was a member of the Turner and Newell (T&N) scheme between 1971 and 1998. He received PPF compensation that was considerably less than what he had expected from the scheme. This was due to a combination of reasons including the 90% rule, the cap and the loss of indexation rights. The CJEU "concluded that Article 8 of the Insolvency Directive 2008/94/EC requires that an individual's expected old-age pension benefits must be protected to a minimum level of 50% in the event of insolvency."[57]

50 Pensions Bill 2013-14 – impact assessments - Annex J – The PPF compensation cap amendments (March 2013)
51 HL Deb 22 January 2018 c892 [Baroness Buscombe]
52 PQ 24981, 4 February 2016; See also HC Deb 7 September 2015 c19
53 DWP, The draft Pension Protection Fund (Modification) (Amendment) (Regulations) 2017
54 HCWS163, 15 September 2016; Gov.UK: Applying the Financial Assistance Scheme increased cap for long service, December 2017
55 Financial Assistance Scheme (Increased Cap for Long Service) Regulations 2018 (SI 2018 No. 207)
56 Grenville Hampshire v Board of the Pension Protection Fund, (CJEU) (C-17/17), September 2018; This was on request for a preliminary ruling from the Court of Appeal in England and Wales - Hampshire v The Board of the Pension Protection Fund [2016] EWCA Civ 786; See also, Opinion of the Advocat General, 26 April 2018
57 Pension Schemes Bill 2019/20 [HL] - Explanatory Notes, para 634

In its response to the judgment in November 2018, the PPF said that there would be a small number of PPF and FAS members affected by the judgement: the vast majority already received more than 50% of the value of their accrued benefits. Pending legislation to implement the ruling, it put in place arrangements that it said would ensure those most affected received an appropriate increase.[58]

Hughes

In April 2019, the pilot's union Balpa submitted an application for judicial review against the PPF and DWP. It claimed that the compensation cap was unlawful, particularly in light of the recent European Court of Justice judgement in the Hampshire case which ruled that noone should receive less than 50% of their expected pension. It also challenged the PPF's 'one-off' method for calculating any uplift and said it would call for an on- going mechanism for calculating compensation.[59] On 22 June 2020, the High Court ruled that:

- The compensation cap was discriminatory on grounds of age. It was unlawful and would have to be disapplied.
- The approach of making a one-off calculation (taken by the PPF following the Hampshire judgement), was permissible but the PPF needed to make sure that each individual, and separately each survivor, over the course of their lifetime received at least 50% on a cumulative basis of the actual value of the benefits that their scheme would have provided;
- Members of schemes in assessment should receive benefits at the level required by the ECJ's '*Hampshire*' judgment.[60]

On 20 August, the PPF lodged an appeal against the requirement set by this judgement to make sure that members and survivors each received at least 50% on a cumulative basis of the actual value of the benefits their scheme would have provided. It said this would require it to amend its methodology and was different to its view of what the Insolvency directive required. In addition, DWP is seeking permission to appeal the judgement that the compensation cap was age discriminatory.[61]

There are FAQs for PPF and FAS scheme members.

Bauer

Another much anticipated judgment, was that of the CJEU in a German case (Bauer). This was because in advance of it, the Advocate General delivered an opinion to the effect that EU Member States were required to establish systems that aim to protect pensions in full. The PPF commented that this view was "a significant departure" from previous rulings, which had recognised a member state's considerable discretion to determine their approach to pension protections (balancing the level of compensation provided with the cost of doing so) and that if the court ruled in line with this, it would "need very careful consideration by Government."[62] In its judgment in December 2019, the CJEU restated that, as a minimum, every individual must receive at least 50% of their accrued benefits. The PPF considered that the implementation methodology it had announced following the Hampshire judgment met this requirement.[63]

58 PPF Annual Report 2018/19, June 2019; See also Court of Justice of the European Union's judgement on Hampshire v PPF, PPF press release, 6 September 2018; Update on CJEU ruling, 21 December 2018; PPF statement on implementing the European Court of Justice ruling, November 2018; Where we are with the European Court of Justice ruling, Feb 2019
59 Pilots await their day in court over pensions, BALPA press release, 1 April 2019
60 PPF website, Court confirms Hampshire methodology is permissible
61 Next steps after court ruling on Hampshire methodology, PPF press release, 19 August 2020
62 The 2020-2021 Pension Protection Fund Levy Consultation Document, September 2019
63 PPF, ECJ Judgment in PSV v Bauer. 19 December 2019

However, the CJEU also ruled that a reduction in benefits which resulted in a member living below the at-risk-of-poverty threshold determined by Eurostat would be "manifestly disproportionate." In its 2019/20 Annual Report, the PPF commented that the implementation of this judgment presented "a significant operational complexity and we are working with DWP to address this challenge."[64]

Beaton

DWP explains that the concept of 'pensionable service' is fundamental to the calculation of pension compensation. Among other things, it governs the compensation payable to those under the scheme's normal pension age, the total benefits which are subject to the compensation cap and the payment of survivors' benefits indexation and revaluation. It says the policy intent has always been that a pension which arose by virtue of a transfer-in to the scheme, where the initial amount of the pension was determined at the time of the transfer payment, is treated as attributable to the person's pensionable service. However, in the Beaton case in October 2017, the High Court determined that, when applying the compensation cap, benefits derived from a transfer-in could not be said to be attributable to pensionable service and could not be aggregated.

DWP said that although the judgment meant that benefits from a transfer-in could not be aggregated with other relevant pension benefits for the purposes of the cap, it had resulted in the legislation being interpreted in ways that were inconsistent with the policy intent and PPF practice, with the potential for perverse and unintended outcomes for a range of individuals:

> The judgment principally considered relevant fixed pensions only in the context of the PPF compensation cap but, in government's view, it would also lead to a number of wider perverse and unintended outcomes for a range of individuals, including some in receipt of survivor benefits. The judgment could result in individuals whose PPF compensation was derived, wholly or in part, from a relevant fixed pension seeing their payments reduced, and in some cases, stop altogether. The government believes that this is unfair and was never the intention when the legislation was amended in 2014.
>
> Given the significant negative implications that the judgment would have for some individuals, the government is proposing to bring forward legislation to remedy the immediate problems caused by the judgment, to ensure that the PPF can continue to administer the compensations regime as intended.[65]

The Government introduced regulations to remedy this for the future, ensuring that a pension derived from a transfer-in would be treated as "attributable pensionable service for the purpose of calculating PPF compensation (except for the purposes of applying a single compensation cap)." This would "ensure that the PPF have the legal basis to pay survivor benefits and to index and revalue payments."[66]

Clause 126 of *Pension Schemes Bill [HL] 2019/21* would make this retrospective – treating the amendment made by regulations as though it had always had effect.[67]

2.5 Early payment

Individuals can choose to draw PPF compensation before normal pension age. However, they must be at least 55 and payment levels are actuarially reduced to take account of the fact that

64 PPF Annual Report 2019/20, p49
65 DWP, Changes to PPF regulations - consultation, July 2019
66 SI 2018/998
67 Explanatory Memorandum to SI 2018/988; Pension Schemes Bill 2019/20 [HL] - Explanatory Notes, para 632-7

compensation will be in payment for longer.[68] This is the case even where a person claims their pension early on ill-health grounds. In this respect, the PPF rules differ from those of many DB schemes, which often allow unreduced early payment of a pension on ill-health grounds. [69]

The issue was also discussed when the *Pensions Bill 2006-07* was before Parliament. Labour Peer, Lord Whitty tabled an amendment with the intention of allowing early payment of unreduced PPF or Financial Assistance Scheme (FAS) compensation on grounds of ill-health.[70] Responding for the Labour Government, Lord McKenzie said he appreciated the difficult choices faced by people unable to work on grounds of ill-health and that many pension schemes offered different options for people retiring early due to ill-health. However, the fact that the PPF and FAS rules did not mirror those of individual pension schemes helped to ensure certainty about the level of payment and about the affordability of the schemes:

> The Government deliberately created the PPF as a compensation scheme that would provide a better level of income overall than did schemes that were underfunded when they were wound up. Without the PPF, people who are taken ill or seriously disabled might have no pension at all to look forward to. We have taken care to ensure fairness and to avoid the trap of complexity that would result from creating a PPF that mirrored all the rules of every pension scheme. This means that we have made no special provision for people to receive compensation early specifically on the grounds of ill health. Instead, we have provided for people to apply for early compensation, subject to the adjustment, without having to explain why they wish to receive it. If we were to do as the amendment suggests, we would need to provide a mechanism for the PPF to determine when someone was suffering from severe ill health. Such matters are not always easy to determine.[71]

2.6 Lump sum payment in cases of terminal illness

In 2008, the Labour Government amended the 2004 Act to allow members of the PPF who are terminally ill to claim a lump sum, bringing this into line with the practice of the FAS.[72] The then Work and Pensions Minister, Lord McKenzie explained that:

> These amendments will allow those who have a progressive disease—which means that their death may reasonably be expected in six months—to apply for a lump sum. This lump sum will be equal to twice the annual rate of compensation that they would be entitled to had they reached normal pension age, in lieu of their future entitlement. Taken together, these amendments will ensure that a member with a terminal illness will be able to access a significant lump sum, averaging in the region of £10,000, using the same rules to define "terminally ill" as those that are used in the financial assistance scheme and in DWP benefits.[73][2]

See PPF leaflet Terminal Ill-health pension benefits (July 2020).

[68] *Pensions Act 2004*, Schedule 7, para 25 and *Pension Protection Fund (Compensation) Regulations*, (SI 2005. No 670), reg 2
[69] HC Deb, 21 November 2005, c1079W; IDS Pension Service, *Pension Scheme Design 2007,* page 46
[70] HL Deb, 6 June 2007, c1218-20; The Financial Assistance Scheme was set up to provide some compensation to schemes that started to wind up before the PPF came into force in April 2005
[71] Ibid, c1220
[72] *Pensions Act 2004, sch 7* as amended by *Pensions Act 2008*, sch 8; HL Deb, 3 June 2008, c83-4
[73] HL Deb, 14 July 2008, c1060;
[2] See *Pensions Act 2008,* Schedule 8

3. Funding

The PPF is funded by a combination of:

- The assets transferred from schemes for which it has assumed responsibility;
- Recoveries of money, and other assets, from those schemes' insolvent employers;
- An annual levy raised from eligible pension schemes; and
- Investment returns on assets held by the PPF.[74]

3.1 The pension protection levy

Structure

The pension protection levy is payable by all UK defined benefit pension schemes whose members would be eligible for PPF compensation if the scheme wound up under-funded on the insolvency of the sponsoring employer (although some schemes may qualify for a levy waiver). It is divided into two parts:

- The **scheme-based levy (SBL)** is based on a scheme's liabilities to members on a section 179 basis.
- The **risk-based levy** takes account of the risk of a scheme's sponsoring employer becoming insolvent (insolvency risk) and the amount of compensation that might then be payable by the PPF (underfunding risk). This has to make up at least 80% of the total the PPF aims to collect. Schemes with very low levels of risk may not have to pay it and schemes can reduce the risk-based levy. Schemes can reduce the risk-based levy by certifying contingent assets and deficit reduction contributions.[75]

The pension protection levy is comprised of a risk-based levy (required by law to be at least 80 per cent of the total) and a scheme-based levy, making up the remainder.[76]

For more information see PPF website: What is the levy and who pays it?

Process for setting the levy

The Secretary of State is required to set a 'levy ceiling' each year, preventing the Board from raising the levy above a set maximum. It is set at a level that "is sufficient to allow the Board of the PPF to raise a levy that ensures the safe funding of the compensation it provides, whilst providing reassurance to business that the levy will not be above a certain amount in any one year."[77] The ceiling is increased each year in line with earnings. It can be increased by more than this, but only if the Board makes a recommendation to that effect and the Treasury approves.[78] The amount of the levy ceiling for the 2020/21 is £1,099,445,505.[79]

Operating within the limits set by Parliament, the PPF sets the rules for calculating the levy and estimates how much it will try to collect. Typically, it aims for the rules to remain broadly unchanged for three-year periods. This has enabled the levy to remain "broadly stable in a

74 PPF, '*Consultation on the Future Development of the Pension Protection Levy*', November 2008, para 2.1.3; *Pensions Act 2004*, s177-181
75 PPF website/levy payers/reduce the levy
76 *Pensions Act 2004*, s175; Explanatory Memorandum to SI 2016/82, para 7.5
77 Explanatory Memorandum to SI 2016/82, para 7.5
78 *Pensions Act 2004,* s178; *Pensions Act 2004* – Explanatory Notes, para 651-653
79 *Pension Protection Fund and Occupational Pension Schemes (Levy Ceiling and Compensation Cap) Order 2020 (SI 2020/101)*

volatile claims environment." [80] The levy is expected to fall over time as a percentage of pension scheme liabilities.[81]

Once the PPF has set its levy estimate, it uses a 'levy scaling factor' to distribute the levy proportionately among eligible schemes.[82] Its evidence to the Work and Pensions Committee explained:

> The funding position of each scheme is assessed using a standard valuation that schemes have to produce every three years. This is then rolled forward to a common date of the start of each levy year (the same data is used to produce our regular review of pension scheme funding). The funding position of the scheme is then 'stressed' to reflect that a claim on the PPF might arise when investments have performed poorly; different types of asset are stressed in different ways.
>
> The levy billed in 2015/16 used a new model to assess insolvency risk. The new model has been developed by the PPF with Experian and with input from the pensions industry and those with a wider interest. It is a statistical model based on company financial data and experience of insolvency amongst sponsors of eligible pension schemes. It is substantially more predictive than similar commercial models. It takes financial information for each of the employers which sponsor a pension scheme, uses a formula applied across different types of employer and provides a one year probability of how likely that company is to become insolvent. These probabilities are tracked on a monthly basis, and the average of the twelve probabilities used to place the employer in a band. This band is then used in the levy calculation.
>
> The individual levy bill of a particular scheme may therefore vary substantially year on year if their funding level or employer strength varies significantly. Employers, and related companies, can provide guarantees and pledges on assets to a scheme, which in turn reduce their risk of making claims, and is therefore reflected in a reduced levy bill.
>
> The individual levy bill payable by any scheme is capped at 0.75 per cent of the scheme's PPF liabilities. The costs of this cross subsidy reflected by this cap is met through the scheme-based levy payable by all schemes.[83]

In its 2017 Report on Defined Benefit pension schemes, the Work and Pensions Select Committee said it supported the risk-based levy provided it adequately reflected risk.[84] In response, the PPF said it was consulting on proposals to improve predictiveness and to ensure scorecards were better tailored to company size "resulting for example, in SMEs and not-for-profits paying levies that better reflect their risks.[85] The Committee welcomed this.[86]

In March 2020, the PPF published its Policy Statement confirming the basis of the insolvency risk model that would be used by Dun & Bradstreet (D&B).[87] In September it said this model was performing well.[88]

Levy estimate for 2021/22

In general, the PPF aims to keep its approach to calculating the levy broadly unchanged for three-year periods. For 2020/21(the last year of the current three-year period), it confirmed that its levy rules would remain "broadly unchanged" but that the levy estimate would increase to

80 PPF Purple Book 2018; For an explanation of the levy estimate process, see Written evidence from the Pension Protection Fund (PPF001), May 2016; Explanatory Memorandum to SI 2018/39 para 7.7
81 Ibid, p59; PPF, Funding Strategy 2018 (page 31)
82 PPF, *The Pension Protection Levy. Policy 2008-09 to 2010-11*
83 Written evidence from the Pension Protection Fund (PPF001), May 2016
84 Work and Pensions Select Committee, Defined Benefit pension schemes, December 2016, para 80
85 Letter from PPF to Work and Pensions Select Committee, 29 March 2017
86 PPF response to defined pensions report welcomed by Committee, March 2017
87 PPF, Policy statement. Insolvency scoring from 2021/22, March 2020
88 PPF, Consultation document: changes to the methodology for the 2020/21 levy year, 25 September 2020

£620 million an increase of eight per cent on average relative to the previous year, reflecting significant increases in scheme under-funding.[89]

Launching its levy consultation for 2021/22 in September 2020 it said that, while at this stage it would typically be looking to propose rules for the next three-year period, in current circumstances it was appropriate to adopt a more flexible stance and be prepared to adjust its rules on an annual basis. This would allow it to make an active choice on the level at which the levy was set in 2022/23, when it had more clarity about the impact of COVID19 and changes to the Pensions Regulator's scheme funding regime.[90]

Its levy estimate for 2021/22 is £100 million less than for the current year. This is partly because the deterioration in insolvency risk scores and scheme underfunding is more than offset by changes to the basis for valuing scheme liabilities on a PPF basis.[91]

COVID19 is expected to have a limited impact on levy scores until 2022/23:

> 1.2.1. It is clear that COVID-19 and the associated lockdown has had a very significant impact on many employers and schemes. Although current insolvency rates remain low, our view is that this reflects the impact of Government support schemes. As these come to an end, we expect an increase in the level of insolvencies and a significant increase in claims on the PPF. However, there is of course considerable uncertainty about these ongoing economic impacts.
>
> 1.2.2. For 2021/22, however, we expect COVID-19 will only have a limited impact on levy bills. This is because our insolvency risk model which we use to score the majority of employers uses accounts information filed with Companies House. Only when accounts are filed covering the period of COVID-19 will they feed through into insolvency risk scores. For the majority of our employers this won't happen in time to impact levy scores used in the 2021/22 levies, the main effect will be seen in 2022/23 invoices. At that point, however, the effects could be substantial – with many employers seeing a worsening in their levy score. All else being equal this would lead to a rise in levy bills.[92]

The PPF proposed changes to reduce the impact of the levy on small schemes (whose risk may be overstated in current calculations) and a reduction in the cap on the "risk-based levy" because in recent years the number of schemes capped had reduced and levies charged risen.[93] On 15 December, it confirmed these measures and the levy estimate of £520 million for 2021/22.[94]

Actions schemes can take to reduce their levy

Pension schemes and employers can reduce the amount of levy they pay "by putting in place contingent assets, such as parent or bank guarantees, or security over property. The PPF also considers deficit reduction contributions – special contributions to bolster the scheme – as reducing the risk of the scheme, which also reduces the amount of the levy bill."[95]

The PPF and CBI produced a leaflet – How to reduce your pension protection levy – listing ten actions businesses could take. There is a levy waiver for schemes that pose very little risk to the

89 PPF announces levy estimate for 2020/21; 2020/21 PPF levy consultation document, 25 September 2019; PPF confirms levy rules for 2020/21, 16 December 2019
90 Defined benefit pension scheme funding, Commons Library Briefing Paper CBP 4877, July 2020
91 *Pensions Act 2004*, s179
92 PPF, Changes to levy methodology for the year 2020/21,
93 Ibid, para 1.5.1-2
94 PPF confirms supportive measures for PPF levy payers following consultation, 15 December 2020
95 PPF and CBI, How to reduce your pension protection levy; See also PPF ways to reduce the levy

PPF.[96] There is a process for challenging decisions – see how to request a levy review on the PPF website.

Consultation on incentivising good governance via the levy

The Work and Pensions Committee also recommended that the levy framework should be re-examined to see how it could incentivise schemes to improve governance. The PPF agreed governance was "of critical importance to delivering positive outcomes for pension scheme members." It had concluded in 2010 that there were "significant barriers" to trying to use the levy to incentivise improvements. However, it was keen to hear if stakeholders thought there was now a case for incorporating a discount for good governance in the levy calculation.[97] It asked for views on how it could measure good governance in a way that is linked to reduction in risk.[98] In September 2017, it said it would not take forward proposals for a levy discount to reward good governance. Two thirds of respondents to its consultation had expressed doubts about either the principle or the practical difficulty of doing so.[99]

Interest on late payments

The Pension Protection Fund (PPF) is funded in part by an annual levy on schemes eligible for PPF protection. Its guide to the Pension Protection Levy explains that once an invoice has been sent, it is due for immediate payment. An interest on late payment charges if 5% pa above the Bank of England base rate starts to accrue after 28 days.[100] The PPF will "consider waiving accrued interest but this will depend on the circumstances of the case."[101]

The calculation, collection and recovery of PPF levies is provided for in the *Pensions Act 2004* (s181). Interest for late payment is provided for in section 181A, which states enabled regulations to "make provision for interest to be charged at the prescribed rate in the case of late payment of a pension protection levy."[102] This was inserted by the *Pensions Act 2008* (s129 and Sch 10).

The Government explained that the PPF needed this power because:

> A significant amount of the Pension Protection Levy is paid late by schemes. While some payments of the 2006/07 levy were paid late because of a dispute or review of the levy invoice, over £100 million was still paid late where there was no dispute or review of the Levy invoice.[103]

In debate in Parliament, the then Pensions Minister Mike O'Brien said there were circumstances in which it might be appropriate to charge it:

> We need the power to tackle the late payment levies and 40 per cent. of the pension protection levy collected for 2006-07 was paid after 28 days, which accounted for about £114 million of the £271 million collected. We had quite a bit of late payment. The hon. Member for Eastbourne rightly asked whether there are circumstances in which it is justifiable to pay late. One of the reasons why we have had a lot of late payment in recent years is that there has been a dispute about the amount of levy. A number of the funds involved have said that the level of risk, for example, that is included in the calculation of the levy is wrong and that they are not as risky as all that. The funds have had it looked at again and, in many cases, it has been agreed that the levy can be reduced.

96 PPF website/FAQ/what is a levy waiver?; *Pension Protection Fund (Waiver of Pension Protection Levy and Consequential Amendments) Regulations 2007 (SI 771/2007)*
97 Letter from PPF to Work and Pensions Select Committee, 29 March 2017
98 PPF, Third Triennium Consultation Document, 23 March 2017
99 PPF, 2018-19 Policy Statement and Consultation Document, September 2017, section 7
100 PPF, Pension Protection Fund – A Guide to the Pension Protection Levy 2020/21, p10
101 Ibid
102 Section 191A
103 DWP, *Pensions Bill – Impact Assessment*, 5 December 2007, para 6.20

> It seems that there was some justifiable reason for a late payment and, in such circumstances, it would be open not to charge interest on the late payments because that was justified; the original levy that was imposed was not right. There are circumstances in which it may be right not to charge interest. Obviously, there are circumstances in which there is no dispute about the level of the levy and payments just arrive late when it would be appropriate to charge interest. I hope that I have answered the various issues that have been raised.[104]

The details (regarding matters such as the rate of interest and the circumstances to be taken into account in deciding whether it is reasonable not to charge interest) were provided for in the *Pension Protection Fund (Misc. Amendment) Regulations 2010 (SI 2010/560),* reg *5*.[105]
In November 2018, the then chair of the Work and Pensions Committee, Frank Field, wrote to the Pensions Minister to express concern that the rate was high compared to the interest rate levied by HMRC for late payment of taxes (3.25%). He asked the Minister to consider whether:

- This interest rate is set at the right level, and whether the burden on small business in particular is appropriate? And
- The law needs to change to allow the PPF to offer SMEs (and not other levy payers) the option of paying the levy by instalments.[106]

In response, the Minister said that the PPF believed the charge encouraged prompt payment:

> Since the introduction of interest on late payment, the average time taken by schemes to pay has reduced from 34 days to 24 days. In practice, interest is only applied in relatively rare cases – around 175 a year, representing just over 3% of schemes, and since introduction in 2010, the PPF has collected less than £2m in interest charges, by comparison with c£4.5 billion of pension protection levy.

He was not convinced there was evidence supported allowing SMEs to pay by instalments.[107]
PPF CEO Oliver Morley said:

> As we have previously set out, the current legislative framework prevents us from introducing different invoice frequency for specific groups. However, upon receipt of their annual invoice, schemes can apply to pay that invoice by instalments under a payment plan. There is also action we can take within the existing framework to address SME concerns. We will revisit our policy for accepting applications to move to a payment plan, including our policy for waiving interest on such a plan.
>
> In parallel, we will continue to work to understand SME concerns more fully…We are carrying out quantitative survey of levy payers and, building on our engagement with the SME Consultation Group, are also establishing a new SME forum which we hope to bring together for the first time in early 2019.[108]

3.2 Investments

Its 2019//20 annual report said its investment strategy had been built to withstand market shocks and that its investments had performed in line with expectations, given the economic backdrop:

> In the last quarter of 2019/20, the COVID-19 pandemic caused market moves of an unprecedented speed, and a depth which had not been seen since 2008. Thanks to our robust investment framework, while there was a negative impact on the portfolio of risk assets, our LDI strategy performed extremely well and our Strategic Asset Allocation performed in line with our expectations, given the economic backdrop. Our investment strategy is built to withstand market shocks from time to time. Additionally, the portfolio was below our strategic risk target as we entered the final quarter of the year as we had

104 PBC Deb 17 February 2008 c490
105 There was consultation on the draft regulations in 2009
106 Letter from chair to Guy Opperman MP regarding PPF levy, dated 12 November 2018
107 Letter from Guy Opperman MP to chair of the Work and Pensions Committee, 4 December 2018
108 Letter from Oliver Morley, Chief Executive PPF to the Chair regarding the PPF levy, 13 December 2018

> earlier taken the decision to reduce risk when assets began to look overvalued. Overall our investments returned 5.2 per cent – the same as in 2018/19 – which was very positive given the market situation. On a one, three and five-year basis our investment portfolio continued to outperform the associated asset class benchmarks.[109]

Information about the PPF's responsible investment strategy and the way it manages the risks and opportunities related to climate change through its investment approach is on its website.

3.3 Self-sufficiency target

The PPF has a target to be self-sufficient by 2030. The reason is that it expects the number of DB schemes to decline and the funding level of surviving schemes to improve:

> In the future we expect there to be fewer claims from schemes on the PPF than today, and therefore the levy we need to collect will be small in comparison to our own assets and liabilities. Our current projection is that this point will be reached in 2030. This doesn't mean we won't be collecting levy – DB schemes supported by employers will definitely still be around after this point and those employers could still become insolvent. At this point, we will need to have confidence that we are holding enough money to pay compensation to members and protect them adequately from the risk of adverse conditions thereafter. We are currently targeting a margin above liabilities that provides sufficient funds in 90 per cent of modelled scenarios based on a very low risk investment approach.[110]

As at 31 March 2020, the PPF had £36.1 billion in invested assets, an increase of £4.1 billion year-on-year, and total consolidated reserves of £5.1 billion – a decrease of £1.0 billion from last year. The PPF commented that this reduction in its reserves was a reminder that it could not be complacent:

> Many of the schemes we protect are underfunded, and it is likely that many schemes' funding positions will have worsened as a result of market volatility – particularly those with relatively high-risk investment strategies. We are also prepared to face an increased level of claims due to higher insolvency rates.

However, this was the risk that the PPF was created to accept and its funding strategy aimed to manage its impact. The probability of success (PoS) in meeting its funding target had fallen from 89% to 83% over the year to March 2020. However, this still indicated a good level of confidence that the PPF was on track to meet its funding target:

> Our focus as a business is to prudently and actively manage all of the factors within our control and so in the event of a further material decline in PoS we would look to manage those factors to mitigate the risk of underfunding at the horizon. At this year end, the uncertainty in our projections is more than usually high, as a result of the coronavirus crisis. There is more uncertainty than normal in our estimates of the current financial strength of the pension schemes we protect, as we need to make some high-level assumptions about the impact of the significant recent market volatility on their asset values. We are also facing a more uncertain claims environment than usual. It is clear that insolvency risk has increased, but at this early stage in the development of the expected worldwide recession, and in the presence of very significant government support for viable companies, it is very uncertain how that will manifest.[111]

Other levers

In the event of assets being insufficient to meet liabilities, the levers available to the PPF Board are to change the levy or alter its investment strategy. It also has the power to restrict inflation-

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[109] PPF Annual Report 2019/20

[110] PPF Strategic Plan 2019/22, p7. In previous years, the PPF produced a separate funding strategy update

[111] PPF Annual Report 2019/20

linked increases to compensation or to ask government to reduce the level of compensation payments.[112] However, these powers would only be used in extremis. When the legislation was before Parliament, the then Pensions Minister Malcolm Wicks explained:

> The provisions in schedule 7 enable the board to increase or reduce the percentage levels of indexation, as we discussed earlier, and revaluation on PPF compensation. That is because the board needs appropriate levels of flexibility to make decisions concerning the effective management of the PPF and its finances. That includes the ability to reduce the percentage levels of revaluation and indexation on PPF compensation, should that be required […] However, we do not expect the board to take lightly a decision to reduce the levels of indexation or revaluation or increase the pension protection levies; I want to emphasise that, not least to my hon. Friend. We are including the provision in the Bill because of the danger one day of very extreme circumstances occurring. I believe that such circumstances are very unlikely, but it is responsible for us to include such a provision.[113]

[112] *Pensions Act 2004,* Sch 7, para 30
[113] SC Deb 30 March 2004 (afternoon), c519-20

4. Pension freedoms

The Coalition Government introduced the 'pension freedom' reforms in April 2015. This was to give people aged 55 and over more flexibility about when and how to draw their defined contribution (DC) pension savings (previously most people had had to buy an annuity). They were not primarily aimed at members of defined benefit (DB) pension schemes (such as final salary schemes) for the majority of whom, it was likely to be in their best financial interests to remain in their DB scheme. However, members of DB schemes had the right to transfer them to another scheme, subject to certain conditions. The Government recognised that the introduction of the pension freedoms might make transfers from DB to DC schemes more attractive. It consulted on whether to remove this right.[114] It consulted on whether this right should continue and decided that it should but that people with 'safeguarded rights' (such as in a DB pension or with an element of guarantee) worth more than £30,000 should be required to take appropriate independent advice first.[115] This is discussed in more detail in Library Briefing Paper CBP 8382.

Transfers out from a DB scheme that had entered a PPF assessment period were already prevented under the *Pensions Act 2004*. Adding to this, the *Pension Schemes Act 2015* prevented their conversion to money purchase benefits.[116] This means the pension flexibilities do not apply to the PPF.[117]

When the legislation was before Parliament, the then Pensions Minister Steve Webb explained the reasons for this:

> Our provisions restrict what can be done with non-money purchase benefits when a scheme is in a PPF assessment period. New clause 17 prevents the conversion or replacement of nonmoney purchase benefits with money purchase benefits. New clause 18 restricts the payment of lump sums to those that would be payable if the scheme transferred into the PPF. Crucially, a scheme needs to be in as steady a state as possible while it is assessed for transfer into the PPF, so that its overall financial position can be determined. In addition, if members were able to transfer or discharge their benefits, this would delay the process and deplete the assets available to be transferred with which to pay compensation to other members. There are no restrictions on the payment, transfer or discharge of money purchase benefits.[118]

He explained that the Government was also legislating to restrict transfers out of schemes that were winding up:

> We want to prevent some members from avoiding any reduction to Pension Protection Fund levels of compensation. Therefore, we want to prevent members from converting non-money purchase benefits to money purchase after a scheme begins to wind up. If we did not do that, there would be a risk that benefits converted to money purchase would be discharged in full, to the potential detriment of other members.[119]

114 HM Treasury, Freedom and Choice in pensions, Cm 8835, March 2014, para 5.15
115 *Pension Schemes Act 2015*, s68
116 Sections 58-9; Explanatory Notes, para 215-6
117 Pension flexibility: effect on PPF and FAS payments, March 2015
118 HC Deb 25 November 2014 c815
119 Ibid

5. The Financial Assistance Scheme

For background, see Financial Assistance Scheme, 2008 – Commons Library Briefing Paper, SN-3085, 22 March 2010

The Financial Assistance Scheme (FAS) was set up under the *Pensions Act 2004* (s286) to provide compensation to members of occupational pension schemes that wound up on the insolvency of the employer between 1 January 1997 and 6 April 2005 – i.e. people not eligible for the Pension Protection Fund (PPF) which was set up for schemes that wound up underfunded from 6 April 2005. 'Solvent employer schemes' which wound up under-funded after 1st January 1997 and before the employer was required to meet the full buy-out cost on 11 June 2003, can also qualify.[120]

Unlike the PPF, which is funded by a levy on occupational pension schemes, the FAS is funded by the taxpayer.[121]

The PPF took over responsibility for administering the FAS from 2009. It closed to new applications in September 2016, ten years later than originally intended.[122] It now covers 147,818 members.[123]

Information for scheme members is on the FAS website. See for example: What being a FAS member means and When you retire. Your guide to the Financial Assistance Scheme

5.1 FAS compensation

From its inception, the FAS was criticised for providing less generous support than the PPF. Initially, it only covered those members of qualifying pension schemes closest to retirement age and provided compensation of up to 80 per cent of "expected core pension" (subject to a cap of £12,000 per year).[124] However, following an extensive campaign, significant extensions to the FAS were announced on three occasions. Announcing the third extension in December 2007, the then Work and Pensions Secretary, Peter Hain, said this resulted in "assistance under the FAS being broadly comparable to compensation paid under the PPF." It meant that, for example:

- All scheme members would be guaranteed 90% (subject to a cap) of their accrued pension at the date of commencement of wind up, revalued to their retirement date;
- Payment of assistance derived from post-1997 service will be increased in line with inflation (subject to a 2.5% limit).[125]

Compensation levels

The FAS provides all members with compensation equal to a maximum of 90% of their expected pension (broadly speaking what they had built up in their former pension scheme before it began to wind-up, revalued to their FAS normal retirement age) subject to a cap (£36,717 in 2020/21).[126]

And from April 2018, an enhanced compensation cap was introduced for FAS members with long service in their pension scheme. The cap is increased by three per cent for each full year of pensionable service, over 20 years subject to a new maximum of twice the standard cap.[127] The

120 *Financial Assistance Scheme Regulations 2005 (SI 2005/1986)*; as amended by *SI 2008/1903*, reg 7
121 HL Deb 22 January 2018 c884 and 889
122 PPF Annual Report 2017-18, p12
123 PPF Annual Report 2019-20, p17
124 Explanatory Memorandum to SI 2007/3851, para 7.1
125 HC Deb 17 December 2017 c100WS
126 When you retire. Your guide to the Financial Assistance Scheme, p4; PPF website – FAQs on entitlement
127 HCWS163, 15 September 2016; DWP consultation, *Applying the Financial Assistance Scheme increased cap for long service*, September to December 2017

Government estimated that 290 out of the 500 FAS members affected by the cap would benefit and that the change would increase the overall cost of FAS payments by approximately £1.2 million per year in the first eight years, before starting to slowly decrease in following years.[128]

The Pensions Action Group continues to campaign for improvements arguing that features of the scheme – in particular, the fact that there is no indexation on rights built up before 1997 – mean that over their lifetime, many FAS members receive considerably less than 90% of the pension they lost.[129]

Legal challenge

As discussed above, in 2018, the Court of Justice of the European Union (CJEU or ECJ) ruled that individual members of pension schemes should receive at least 50 per cent of the value of their accrued pension benefits in the event of employer insolvency.[130]

Responding to the judgment on 6 September 2018, the PPF said that the vast majority of FAS members would "already receive compensation in excess of 50 per cent of their accrued old age benefits and we expect the number of members affected by this ruling to be very small."[131]

In November 2018, it said it expected that for the FAS members who were receiving less than 50 per cent of their entitlement, it would be mostly due to the cap and/or the FAS policy on indexation and revaluation. Although the ruling was clear that members should receive at least 50% of the value of their accrued old age benefits, it did not provide complete clarity on how that is to be achieved. The PPF expected that the Government would implement the ruling by introducing legislation and it was also possible that there could be further court rulings. However, this would take time, so it was right for the PPF to start to take action to implement the ruling. It would work on a methodology for implementing the ruling and would prioritise those most affected first. This meant it would start with those impacted by the long-service cap, before moving on to those impacted by the cap and then to everyone else.[132]

In April 2019, the PPF said it would begin making payments to the most significantly affected FAS members.[133]

For the time being, the process does not capture members of FAS schemes wound up by a solvent employer because the legal challenge was under the Insolvency Directive and because there is currently no legislation under which the PPF could pay any increase to FAS members of solvent schemes.[134] (Although the FAS – like the PPF – was originally targeted at schemes wound up under-funded by insolvent employers, it was extended in 2008 to members of schemes wound up underfunded by solvent employers between 1st January 1997 and 11 June 2003 (from which point they could only do so by meeting the full buy-out cost).[135] This was on the basis that their position was not materially different to those in 'insolvent schemes' – they were likely to have lost pensions and the employer had fulfilled their legal duty.)[136]

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128 HL Deb 22 January 2018 c884; *Financial Assistance Scheme (Increased Cap for Long Service) Regulations 2018;* SI 2018/207
129 Pensions Action Group, Our Financial Assistance Scheme issues in a nutshell, March 2020
130 Grenville Hampshire v Board of the Pension Protection Fund and Secretary of State for Work and Pensions, Sept 2018
131 'Court of Justice of the European Union's judgement on Hampshire v PPF', PPF, 6 September 2018
132 'Court of Justice of the European Union judgement – update', 15 October 2018; Update on the European Court of Justice ruling, 21 December 2018
133 'We begin implementing the European Court of Justice ruling', PPF, 1 April 2019
134 FAS FAQs for European Court of Justice ruling, 2019
135 HC Deb 17 December 2017 c100WS; *Financial Assistance (Miscellaneous Amendment) Regulations 2008 (SI 2008/1903)*
136 Financial Assistance Scheme (FAS) *Review of Assets, Final Report*, December 2007, Foreword

In May 2020, the High Court heard a challenge to the way the PPF implementing the ruling. It ruled that its approach of making a one-off calculation was permissible. However, over the course of their lifetime each individual, and separately each survivor, must receive at least 50% on a cumulative basis of the actual value of the benefits that their scheme would have provided.[137] In August 2020, the PPF lodged an appeal against this ruling.[138]

The PPF has produced FAS FAQs for the European Court of Justice ruling.

Indexation

In line with PPF rules, FAS compensation payments are not index-linked on rights accrued before April 1997. In debate in 2015, the then Work and Pensions Minister, Mark Harper explained:

> The FAS reflects the statutory requirement on all schemes, which is to index post-April 1997 accruals in line with the consumer prices index, capped at 2.5%. My hon. Friend did not think that was in line with the PPF, but in fact it is. The PPF has the same indexation post April 1997, which is CPI, capped at 2.5%. The PPF also pays 90% of the expected pension, so the FAS is in line with the PPF. It would be difficult to argue that the FAS, largely funded by the taxpayer, should be more generous by paying to index pre-1997 accruals than the PPF, which is partly funded from a levy on pension schemes. If we did index the pre-1997 accruals, that would not be inexpensive. It was estimated in 2010 that providing indexation on all assistance to all FAS recipients in line with the retail prices index, as it was then done, capped at 2.5%, would cost an extra £845 million of taxpayers' money. That would be the net present value. If we accept that the money available is limited, a choice has to be made. We could provide more generous indexation, which would benefit those pensioners who live longer, but the cost of doing that is that we would pay a smaller percentage of pensions at the beginning. I think the scheme has made the right judgment.[139]

More information

Information about being an FAS member is on the PPF website – see What being an FAS member means and FAS booklets.

The background to the scheme is in the following Commons Library Briefing Papers Financial Assistance Scheme – developments to 2007 (14 May 2008) and Financial Assistance Scheme – 2008 onwards (March 2010).

137 Hughes v PPF and Secretary of State for Work and Pensions EWHC [2020] 1598 (admin)
138 FAQS about the European Court of Justice ruling for FAS members,
139 HC Deb 10 April 2015 c201WH

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