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The Pension Protection Fund

In the Pensions Bill published in February 2004, the Government unveiled its plans for a pensions compensation scheme. The pension protection fund (PPF) is aimed at members of underfunded defined benefit (DB) schemes whose employer goes bust.

Some background

- The PPF will be overseen by an independent body, the Board of the PPF.
- The Board's main functions will involve managing and investing the PPF.
- The PPF will only apply to employer insolvencies occurring after the date it comes into force (Spring 2005?). (The Government is considering possible retrospective compensation separately.)

The PPF

When might it apply?

- The Board will become involved in a scheme if it receives:
  - a notice from an insolvency practitioner that an "insolvency event" has occurred in relation to the employer; or
  - an application from the scheme trustees[1] or a notice from the new Pensions Regulator that the employer is "unlikely to continue as a going concern".
- An assessment period will follow, which allows the Board time to consider whether or not a scheme should transfer to the PPF.

Assessment periods

The effect on schemes

- During an assessment period:
  - contributions and benefit accrual cease;
  - no transfer payments may be made;
  - no new members may join;
  - pensions in payment are reduced to the PPF level;
  - the Board may give trustees directions about the exercise of certain powers (including investment).
- Essentially, the PPF will only assume responsibility for a scheme if there is no chance of a scheme rescue and there are insufficient assets to secure the PPF level of benefits with an insurer.

1 This places a potentially heavy burden on trustees to monitor the employer's financial strength.

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The benefits

In summary

- Ill-health retirees, together with pensioners and members over "normal pension age" (as defined by the scheme's own rules), will receive 100% of their benefits.
- Non-pensioners and other early retirees will receive 90%, subject to an overall "compensation cap" (initially set at £25,000).
- Increases on pensions in payment will only apply to benefits accrued post-5 April 1997, capped at 2.5%.
- A 50% spouse's pension will be payable.

The levies

- The flat rate levy will be based on scheme-specific factors, such as the number of members and pensionable payroll.
- The risk based levy (which will not apply in the PPF's first year) can take account of factors such as the scheme's funding, investment strategy and the employer's credit-rating.
- An administration levy may also be charged to pay for set-up and on-going administrative costs.

Protecting the PPF

Moral hazard

To ensure that levy payments do not subsidise "unscrupulous employers" and to curtail calls on the PPF, the Pensions Bill contains new clauses which will allow the Pensions Regulator to:

- pursue an employer who exits a scheme leaving a debt behind;
- call upon other group companies to provide financial support to a pension scheme employer with insufficient assets to meet a debt;
- undo a transaction at an undervalue made by a pension scheme.

Conclusion

The PPF is based on the US "Pension Benefit Guaranty Corporation" which is reported to be $11bn or so in deficit. It therefore remains to be seen how much protection the PPF will provide in the long-term to members cast adrift when their employer goes under. Or how much it will cost.

This edition of Sackers Extra News is one in a series produced by our Pensions Reform Team, providing information to help you react and respond to current developments in the simplification and reform of pensions.

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