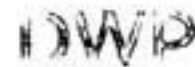




From the Secretary of State
for Work and Pensions
SOS/05/3253

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Dear Terry

Thank you for your open letter of 5th January regarding the Pension Protection Fund and the Financial Assistance Scheme. The Government is grateful for the support you have shown in our aim to achieve a system of pension protection.

In your letter you state that we have introduced a retrospective element to the Pension Protection Fund. This is not the case. For a scheme to enter the Pension Protection Fund the employer must have experienced a Qualifying insolvency event after the date when the Pension Protection Fund goes live, i.e. from 6th April 2005 and the scheme must not have commenced wind up before that date.

Further you mention the possible risk of several schemes waiting to enter the Pension Protection Fund when it goes live. Even in the event of a number of schemes or a sponsoring employer of a large scheme entering insolvency on 6 April 2005, the Pension Protection Fund would be able to cope because it has been designed to ensure that it is robust enough to deal with any demands that may be placed on it in its formative years.

The bill for any deficit does not require payment immediately. The Pension Protection Fund only has to make payments to pensioners, for many individuals this may be 20 or 30 years away.

The Pension Protection Fund will pay benefits at a lower level than the original scheme (compensation cap, applying Pension Protection Fund rules for indexation and revaluation, 90% to non-pensioners). This significantly reduces any deficit that the Pension Protection Fund has to make good.

The immediate payments the Pension Protection Fund has to make (which at the very earliest will be from April 2006 because of the need for a scheme to pass through the assessment period) are much smaller than the deficit figure and can be met by the Pension Protection Fund from its first levy collections.

In addition to collecting the levies, the Fund will take over the assets of a scheme, which even in severely underfunded schemes, is likely to be sufficient to meet early claims by scheme members.

We have designed the Pension Protection Fund to be as financially self sufficient as possible. In the event that the Pension Protection Fund was to find itself in a difficult financial situation, there are several methods of recourse it could take. It would only be in extreme circumstances that the Pension Protection Fund would reduce the amount of benefit payable.

You raised a number of issues relating to the Financial Assistance Scheme in your letter.

You comment on the size of the budget allocated from taxpayers' money to the FAS, and the extent to which you estimate it can provide assistance. We have been in consultation with a range of stakeholders, including the NAPF, as we explore a number of ways of using the available funds to get the money to those in greatest need. As we said in December, we hope to be in a position to announce what we propose by way of indicative assistance levels to those facing the most urgent losses early this year.

The Government believes that £400m of public money should make a considerable contribution to helping those members facing the most significant losses to their expected pensions. As we have previously said the FAS will not give everyone all of what they want – the primary objective is to provide significant help to those who have lost the most.

We have not introduced a compulsory levy or charge on businesses to help fund the FAS. However, we will continue to encourage the various facets of the pensions industry to support the FAS, either by voluntary contributions or assistance in kind. We are, of course, most grateful for the valuable assistance in kind that has been offered by the pensions industry to date, including the NAPF, both in sharing their expertise through the FAS Industry Working Group, and in supporting the data collection exercises that enhance our understanding of the problems which the FAS must address. We maintain a firm hope that we will receive further support from the pensions industry as a whole, and believe that they have a strong interest in doing so.

You further suggest that alternative sources of funding for the FAS be fully explored, and specifically mention unclaimed national savings and the surplus in the National Insurance Fund (NIF) as possibilities.

We stated in the March 2004 Budget that it is right that when unclaimed assets cannot be reunited with their owners they should be reinvested in society. To this end, the Balance Charitable Foundation has been established to reinvest bank and building society assets in the charitable and voluntary sector. We believe that unclaimed assets held by National Savings and Investments are already re-invested in society – they are used to fund schools and hospitals – so there is no need for further action. There are no plans to use such assets to provide assistance for those people who have lost pensions, where we have already said how we intend to proceed.

We are similarly not disposed to make use of any NIF surplus. Any surplus of income over expenditure in the NIF is used to buy gilts. This reduces the Government's need to borrow elsewhere, but it means that the surplus is already taken into account in financing Government spending. Any increase in benefits which reduced the surplus would result in increased Government borrowing.

Expenditure from the NIF is expected to increase significantly over the next 60 years (even if benefits continue to be uprated by prices). As we both know, pensions are a long-term business. We do not want to plan for the long-term on the basis of a snapshot of the NI fund. People are living longer, and as the Government Actuary has made clear, there are a number of assumptions made about employment and unemployment, contracting out and earnings levels. Small changes can have a marked impact on the balance of the fund, especially in the longer term. We therefore do not think it appropriate to use the NIF to fund the FAS.

Yours sincerely

Alan

ALAN JOHNSON