

Chapter 6: Improving trust in private pensions

Objectives

- 6.1 The Bill makes a number of changes relating to the Pension Protection Fund and the Pensions Regulator (the Regulator) to improve the administration of the institutions and enhance the service they provide to their various customers.
- 6.2 These changes are informed by the operation of the institutions since they opened for business in April 2005, and reflect the need to continue to build trust and confidence in private pensions as a means of saving for retirement, without placing undue burdens on the institutions' customers, including employers who provide occupational pension schemes and those who administer them.

Rationale for reform

The Pension Protection Fund

- 6.3 The operation of the Pension Protection Fund has revealed a small number of areas where improvements to legislation will enable the Pension Protection Fund to operate more efficiently, and provide enhanced and more equitable treatment for its customers. These changes are necessary to ensure that recipients of Pension Protection Fund payments receive pension compensation which properly reflects the level of pension they would have received at that point in their life. They will also ensure that divorcing couples are able to share compensation within a settlement in a similar way as they would if a scheme had not entered the Pension Protection Fund.

The Pensions Regulator

- 6.4 The Pensions Regulator replaced the Occupational Pensions Regulatory Authority as part of a new risk-based and proportionate regulatory regime, which applies greater scrutiny where it considers member benefits are most at risk. In the course of developing its role, functions and powers over the past two years, an area has been identified where an amendment to legislation will enable the Regulator to deliver its statutory objectives more effectively.

The Financial Assistance Scheme

- 6.5 Following the Financial Assistance Scheme (FAS) Review of Assets, which reported in December 2007, the Government announced its intention to take over the available assets remaining in the qualifying schemes and to guarantee

assistance to 90% to be paid from normal retirement age (subject to a lower age of 60). In addition, the Government said it would: extend assistance to the members of certain schemes which wound up under-funded where the employer was still solvent; pay assistance early to those too ill to work and over age 60; increase assistance derived from post-1997 service each year in line with inflation (subject to a 2.5% limit); and make lump sum payments where a member's share of fund allows.

- 6.6 The costs to the Government of the extensions to the FAS, announced following the Young Review were set out in a Review of the FAS estimates also published in December 2007. The document can be found at: <http://www.dwp.gov.uk/lifeevent/penret/penreform/fas/fas-costs.pdf>
- 6.7 Some of the assets the Government intend to take over relate to members who would otherwise have had their benefits met in full by their pension schemes, and who will now instead be paid those benefits by the FAS.
- 6.8 Currently the FAS can only make payments to those qualifying members of qualifying schemes who do not receive their benefits in full from their underfunded pension scheme. The definition of qualifying member has now been changed to enable the FAS to make payments to those members who are entitled to receive their benefits in full.
- 6.9 This change does not of itself have any direct impact on the pension schemes or the members affected. Regulations will set out the full details of those members who will qualify for payments by the FAS. The regulations will be subject to consultation and Parliamentary debate and be accompanied by a further impact assessment as appropriate.

Pension Protection Fund compensation sharing on divorce

- 6.10 Currently, on divorce or dissolution of a civil partnership, any pension assets are valued and may be shared or transferred as part of the divorce settlement. The Pension Protection Fund is not a pension scheme, and therefore these provisions do not apply. It is therefore intended that provision be made for valuing compensation, issuing court Orders in respect of the compensation, and the implementation of those Orders by the Pension Protection Fund.

Costs and benefits

Public sector

- 6.11 Detail concerning the method of calculation of shares of compensation and the information that the Pension Protection Fund will need to provide will be contained in secondary legislation. The Pension Protection Fund does not expect that the administrative costs will be significant and, other than set-up costs the

legislation will provide, the costs of implementing compensation sharing Orders for couples will be met by those couples.

Individuals

6.12 This proposal will enable couples undergoing divorce or dissolution of marriage or civil partnership to reach greater independence and fairer settlements by enabling the courts to share Pension Protection Fund compensation in the same way that they can currently share pensions. This will allow members of couples who have had less opportunity to contribute to their own pension, especially women, carers and disabled people, or those who have had lower earnings, to acquire a share of the compensation due to their ex-spouse where this forms one of the couple's more significant assets.

Employers

6.13 There will be no impact on employers.

Gender impacts

6.14 Men are more likely to have significant levels of Pension Protection Fund compensation than women¹⁴³. This means that men are more likely to have reduced compensation following a divorce. However, this would only be as a result of a fair settlement with their ex-spouse.

6.15 This measure is likely to lead to enhanced opportunities for women and carers who are less likely to have entitlements to Pension Protection Fund compensation in their own right.

Race and disability impacts

6.16 It is not anticipated that there will be any negative impacts for any ethnic group or for disabled people.

Competition impact

6.17 There should be no effect on business other than the requirement for some parts of the legal profession to familiarise themselves with the new legislation.

Operation of the Pension Protection Fund

6.18 The measures intended to improve the operation of the Pension Protection Fund and to improve the service it delivers are:

¹⁴³ Pages 75 and 76 of the Pension Protection Fund Annual Report and Accounts 2006/07 HC1018. The report shows that both for deferred members and pensioner members of schemes in the Pension Protection Fund in March 2007 men outnumbered women by more than 10 to 1. The Pension Protection Fund expect the trend to continue to show men outnumbering women by a large degree given the nature of the schemes in assessment.

- to ensure that when the recipient of a pension sharing order becomes entitled to compensation from the Pension Protection Fund, the level of that compensation reflects revaluation to take account of inflation where appropriate;
- to ensure that the level of compensation due can be adjusted upwards and downwards to reflect increases and reductions in the level of pension payments had the scheme not entered the Pension Protection Fund;
- to ensure that compensation can be delayed where doing so would be in the interests of the member and would ease the administration of the Pension Protection Fund;
- to allow for the actuarial adjustment to enhance the value of delayed payments;
- to clarify the definition of “normal pension age”; and
- to clarify the meaning of “admissible rules” used to define the level of compensation paid.

Costs and benefits

Public sector

6.19 Taken together these measures will provide the opportunity for small operational efficiencies within the Pension Protection Fund and will ensure that a lack of clarity in the legislation does not lead to additional burdens being placed on the Fund.

Individuals

6.20 These measures will ensure a more equitable distribution of compensation with a closer match between compensation being paid and the benefits the person would have got from their pension scheme if it had not entered the Fund.

Employers

6.21 The measures will help ensure there are no unforeseen demands placed on the administration levy.

Race and disability impacts

6.22 It is not anticipated that there would be any negative impacts for any gender, ethnic group or for disabled people, but the measure is likely to lead to enhanced opportunities for women, disabled people and carers.

Competition impact

6.23 The measures will help ensure there are no unforeseen demands placed on the administration levy.

Interest on late payment of the Pension Protection Fund Levy

6.24 The Pension Protection Fund is responsible for collecting the Pension Protection Levy – £675 million for 2007/08¹⁴⁴ – which is invested in order to fund compensation to members of eligible defined benefit occupational pension schemes whose employers have gone insolvent.

6.25 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 million¹⁴⁵ was still paid late where there was no dispute or review of the Levy invoice.

6.26 At present, there is no power in the Pensions Act 2004 for the Board of the Pension Protection Fund to deter delayed payment of the Pension Protection Levy. The Bill therefore makes provision to charge a prescribed rate of interest on late payment of the Pension Protection Levy and for the waiver of interest charges in certain circumstances.

6.27 Any interest payments received would be available for investment as part of the Pension Protection Fund, and compensate for the investment income foregone by the Fund. However, we would expect the fact that interest would be charged on late payments would reduce the incidence of late payment, as schemes would aim to pay Levy bills more promptly to avoid paying interest.

6.28 The rate of interest will be included within regulations on which we would consult with the pensions industry and other interested parties. If the Pension Protection Fund were to have charged interest on late payments where there was no dispute or review (referred to in paragraph 6.20) and at a rate of interest of, say, the current Bank of England base rate of 5.75 per cent, interest charges would have amounted to around £600,000.

6.29 For similar reasons, the Bill will make provision to enable interest to be charged on late payment of the Fraud Compensation Levy, the Pension Protection Fund Administration Levy, the Pension Protection Fund Ombudsman Levy and the General Levy.

6.30 We recognise that there will be circumstances where there are legitimate reasons for late payment of levies and regulations may provide for the waiving of interest charges in prescribed circumstances.

¹⁴⁴ 2007/08 Pension Protection Levy Estimate Consultation Document, published December 2006.

¹⁴⁵ Data on late payment of the Pension Protection Levy was provided to DWP during September 2007.

Costs and benefits

Public sector

6.31 It is anticipated that the Pension Protection Fund will collect interest relating to late payment of the Pension Protection Levy and the Fraud Compensation Levy. The set-up costs of implementing the administration of interest charging for these levies has yet to be determined but are estimated to be in the region of around £15,000 and would be recovered from pension schemes through the Pension Protection Fund administration levy, of which £15,000 would form a very small proportion, i.e. less than 0.1 per cent based on current rates.

6.32 We anticipate that the Regulator will collect interest relating to late payment of the Pension Protection Fund administration Levy, the Pension Protection Fund Ombudsman Levy, and the General Levy. The set-up costs of implementing the administration of interest charging for these levies has yet to be determined but are estimated to be between £10,000 and £20,000. The set-up costs will be recovered through the General Levy which funds the administrative costs of the Regulator, of which this amount would form a very small proportion, and less than 1 per cent based on current rates.

Employers

6.33 Pension schemes that are eligible for Pension Protection Fund compensation will only be subject to interest charges in the event of late payment of levies. They may also incur an administrative cost of paying interest in relation to the late payment of levies, but this would be negligible in terms of the total running costs of a pension scheme.

Race and disability impacts

6.34 There will be no negative impacts of this proposal on any ethnic group or for disabled people.

Competition impact

6.35 It is anticipated that there will be no impact on competition between businesses.

Powers of the Pensions Regulator: Amendment to Section 231 of the Pensions Act 2004

Summary of policy

6.36 The Regulator's powers in respect of the funding requirements for private sector defined benefit schemes are set out in Part 3 of the Pensions Act 2004

(the 2004 Act). They include the power to direct the actuarial assumptions which must be used in the calculation of a pension scheme's technical provisions (defined as the amount required, on an actuarial calculation, to make provision for the scheme's liabilities).

6.37 The 2004 Act lists the specific circumstances in which these powers may be exercised, and these include a failure to comply with the requirements relating to the preparation of a scheme's statement of funding principles, its schedule of contributions, or any recovery plan. A breach of any of these requirements allows the Regulator to use any of its scheme funding powers.

6.38 Doubt has been expressed as to whether the legislation currently allows the Regulator to use its scheme funding powers where the sole concern is that the actuarial assumptions used in the calculation of a scheme's technical provisions do not appear to have been chosen prudently by the trustees. This amendment clarifies that the Regulator can use its scheme funding powers where the actuarial assumptions chosen by the trustees do not appear to be prudent.

Costs and benefits

6.39 This amendment is intended to ensure that the Pensions Regulator has appropriate powers to allow it, in cases of concern, to be more effective in persuading the trustees and the sponsoring employer to agree to the use of prudent actuarial assumptions. This would not alter the total costs of providing the pension benefits promised by the scheme in the long term, although it could in some cases result in higher contributions in the shorter term, and hence affect the pace at which the pension benefits under the scheme are funded. Apart from this effect (which could apply to the small number of funded public services schemes which are subject to Part 3 of the 2004 Act), the amendment is not expected to have any impact on public finances.

Gender, race, disability and competition impact

6.40 The amendment is not expected to give rise to any gender, race, disability or competition impact issues.

Powers of the Pensions Regulator to appoint trustees

6.41 The Regulator's powers to appoint trustees to pension schemes are set out in Section 7(3) of the Pensions Act 1995. These powers may be exercised where it is necessary to:

- secure that the trustees as a whole have, or exercise, the necessary knowledge and skill for the proper administration of the scheme;
- secure that the number of trustees is sufficient for the proper administration of the scheme; or
- secure the proper use or application of the assets of the scheme.

6.42 The current “necessary” test means that the Regulator may only appoint a trustee if it is satisfied that there is no other option available. The “necessary” test was introduced in the context of a different regulator and a different market environment. The “necessary” test requires a high burden of proof which can inhibit appropriate regulatory intervention unnecessarily.

6.43 This Bill introduces a new “reasonable test” which would fit better with the Regulator’s 2004 Act powers. This measure is intended to ensure that the Regulator has appropriate powers to allow it, in cases of concern, to be more effective in protecting the interests of members by appointing trustees to the scheme. Any trustee appointed by the Regulator will either be a scheme member or an independent trustee appointed from a register held by the Regulator. Independent trustees are eligible to be on that register only if they agree to a monitoring of fees by the Regulator to ensure that the level of fees charged is reasonable.

6.44 This measure also extends the legislation by adding a new ground for intervention which would enable the Regulator to act where it is necessary to protect the interests of members. The current power was introduced for a regulator which was reactive rather than risk-based. Given the rapidly developing buy-out market and the risks that it presents, it is appropriate to enable the Regulator to act swiftly and appropriately to protect member benefits.

Costs and benefits

6.45 The costs of the independent trustees would be borne by the scheme but this would not alter the total costs of providing the pension benefits promised by the scheme in the long term. The measure is not expected to have any impact on public finances.

Gender, race, disability and competition impact

6.46 This measure is not expected to give rise to any gender, race, disability or competition impact issues.