Pension
Protection
Fund

An Introductory Guide to the Pension Protection Fund

This leaflet provides an introduction to the Pension Protection Fund. It is not intended to be a definitive guide. It explains the basic principles of how the Pension Protection Fund will operate in relation to a single employer pension scheme.

For more detailed guidance visit the Pension Protection Fund website at **www.pensionprotectionfund.org.uk**

What is the Pension Protection Fund?

The Pension Protection Fund, which becomes operational from 6 April 2005, was established by the Pensions Act 2004. Run by an independent Board, it has been designed to pay compensation to members of eligible *defined benefit pension schemes*, when there is a qualifying *insolvency event* in relation to the employer, and where there are insufficient *assets* in the pension scheme to cover Pension Protection Fund levels of compensation.

Which schemes will be eligible for the Pension Protection Fund?

Broadly speaking, the Pension Protection Fund applies to certain *occupational* defined benefit *pension schemes* based in the UK, providing they were not being wound up immediately before 6 April 2005.

The Pension Protection Fund website provides more detailed guidance on schemes which are and are not eligible for the Pension Protection Fund.

How will the Pension Protection Fund be paid for?

Funds will be raised through compulsory levies on all schemes that are eligible for the Pension Protection Fund. In addition, when the Pension Protection Fund assumes responsibility for a scheme, it will also take in the remaining assets of that scheme to help pay towards any Pension Protection Fund compensation.

Further details on the levies can be found on the Pension Protection Fund website.

When would a scheme be taken over by the Pension Protection Fund?

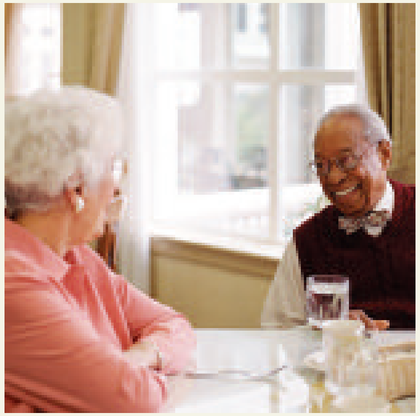
In broad terms, if an insolvency event occurs in relation to the employer of an eligible scheme on or after 6 April 2005, then a Pension Protection Fund *assessment period* will normally begin for that scheme.

What happens during an assessment period?

During the assessment period the Board looks to determine whether a scheme is eligible for entry into the Pension Protection Fund. During this period the scheme continues to be administered by its *trustees*, subject to various restrictions and controls.

During the assessment period the Pension Protection Fund will look to establish the answer to two main questions:

1. Can the scheme be rescued? (For example, can the original employer continue as a going concern, or is another employer going to take the original employer over and assume responsibility for the scheme.)
2. Can the scheme afford to secure benefits which are at least equal to the compensation that the Pension Protection Fund would pay if it assumed responsibility for the scheme?



If the answer to either of these questions is 'yes' then the Pension Protection Fund will cease to be involved with the scheme once the relevant processes and procedures have been completed.

However, if the answer to both the questions is 'no', and the relevant processes and procedures have been completed, then the Pension Protection Fund will assume responsibility for the scheme and compensation will then become payable.

A Pension Protection Fund assessment period is likely to last a minimum of one year and could be longer, depending on the complexity of the financial situation of both the employer and the scheme, and the possibility of a scheme rescue.

How much compensation will be provided?

Broadly speaking the Pension Protection Fund will provide two levels of compensation:

For individuals that have reached their scheme's normal pension age or, irrespective of age, are either in receipt of survivors' pension or a pension on the grounds of ill health, the Pension Protection Fund will pay **100% level of compensation**.

In broad terms, this means a starting level of compensation that could equate to 100% of the pension in payment immediately before the assessment date (subject to a review of the rules of the scheme by the Pension Protection Fund).

The part of this compensation that is derived from pensionable service on or after 6 April 1997 will be increased each year in line with the Retail Prices Index capped at 2.5%. This could, potentially, result in a lower rate of increase than the scheme would have provided.

For the majority of people below their scheme's normal pension age the Pension Protection Fund will pay **90% level of compensation**.

In broad terms and in normal circumstances, this means 90% of the pension an individual had accrued immediately before the assessment date (subject to a review of the rules of the scheme by the Pension Protection Fund) plus *revaluation* (in line with the Retail Prices Index capped at 5%) for each year between the assessment date and the commencement of compensation payments. This compensation is subject to an overall cap which equates to £26,050 at age 65 (the cap will be adjusted according to the age at which compensation comes into payment).

Once compensation is in payment, the part that derives from pensionable service on or after 6 April 1997, will be increased each year in line with the Retail Prices Index capped at 2.5%. Again, this could result in a lower rate of increase than the scheme would have provided.

In addition there will also be compensation for certain survivors.

The Board has the ability to alter the levy to meet its liabilities. However, in extreme circumstances compensation could be reduced.

- Revaluation and *indexation* could be reduced by the Board of the Pension Protection Fund if circumstances required it.
- Levels of compensation could be reduced by the Secretary of State on the recommendation of the Board of the Pension Protection Fund.

Where further mention is made in this leaflet to compensation please refer back to this section.

What will the compensation be based on?

Here are some examples of how compensation is calculated. Please note these are illustrative only and are not a definitive statement of law, or how the calculation will apply in each case. They are intended to act as a broad guide only. All compensation payable will be subject to the review of both the scheme's rules and any recent discretionary increases.

Existing Pensioner

Under normal circumstances, a 75 year old *pensioner* who retired in 1995 and is now receiving a pension of £100 per week will continue to receive that amount (£100 per week) as compensation from the Pension Protection Fund.

Person yet to retire

The compensation payable to those who have yet to reach the scheme's normal pension age is normally based on:

- pensionable salary at the point pensionable service ends;
- number of years in the scheme; and
- the *accrual* rate of the scheme.

Compensation is also increased to keep pace with inflation (capped at 5%).

So if a 35 year old *active member* was on a salary of £18,000 and had 10 years of pensionable service in his scheme at the time of the insolvency event, with an accrual rate of 1/60th, his compensation would be calculated as follows:

(Years of service / Accrual rate)
x Salary on leaving = ?

(10 / 60) x £18,000 = £3,000

10 [years of service] / **60** [accrual rate]
x £18,000 [final salary] = **£3,000**

This person would be entitled to compensation of 90% of £3,000 per year. This equates to £2,700 per year (revalued from the time of the insolvency event to normal pension age in line with the Retail Prices Index, capped at 5%).

The role of the trustees

During an assessment period, the trustees of the scheme retain responsibility for the administration of the scheme and for communicating with and making pension payments to scheme members. The trustees must continue to act in the interests of all the scheme members.

However, during an assessment period, various restrictions and controls will apply in relation to the scheme. In particular, pensions will be restricted to Pension Protection Fund compensation levels. With the current levels of compensation, this will usually mean that pensioners will continue to be paid the same amount of pension as they were receiving before the employer's insolvency event. However, anyone coming up to retirement during the assessment period will be paid a pension at the 90% level (capped at £26,050 per annum in 2006).

The role of The Pensions Regulator

The Pensions Regulator will focus on protecting the benefits of scheme members. It will be responsible for addressing fraud, bad governance and poor scheme administration, as well as encouraging best practice through education and guidance.

Once a scheme enters an assessment period, the Pension Protection Fund will work closely with the Regulator, keeping it informed of any relevant developments relating to the scheme. The Regulator may use its powers when problems arise on individual schemes.

For further information on The Pensions Regulator visit their website at www.thepensionsregulator.gov.uk

The role of the Pension Protection Fund

During an assessment period, the Pension Protection Fund will undertake a monitoring role in relation to the trustees of the scheme. This is to ensure that the trustees maintain the scheme in an appropriate manner for potential entry to the Pension Protection Fund. In certain circumstances, the Pension Protection Fund can issue directions to trustees in relation to areas such as the investment of the scheme's assets, the incurring of expenditure and the bringing or conduct of legal proceedings.

The Pension Protection Fund will also monitor the progress of the insolvency proceedings, liaising closely with the insolvency practitioner.

Where the Pension Protection Fund ultimately assumes responsibility for a scheme, arrangements will then be made to pay compensation to the scheme members.

Should I contact the Pension Protection Fund?

During an assessment period

Until the Pension Protection Fund formally assumes responsibility for a scheme, it remains the responsibility of the trustees to pay pensions and to keep members informed of any new developments. Scheme members are therefore advised to continue to direct any questions to their scheme's trustees during an assessment period.

The Pension Protection Fund website will contain details of schemes entering an assessment period.

Once the Pension Protection Fund assumes responsibility for a scheme

All members of the scheme will be notified of the relevant contact details for the Pension Protection Fund, as well as future arrangements for compensation payments.

The Pension Protection Fund website will contain details of schemes which the Pension Protection Fund assumes responsibility for.

Further information

Further information and guidance is available on the Pension Protection Fund website at **www.pensionprotectionfund.org.uk**

You can write to us at:

Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon
Surrey
CR0 6SR

Glossary

Accrual rate – In a defined benefit pension scheme this is the rate at which pension benefits build up for the member. They will get a certain amount for each year of pensionable service.

Active Member – A person who is in pensionable service under an occupational pension scheme.

Assessment Period – The time when a scheme is being assessed to see if the Pension Protection Fund can assume responsibility for it.

Assets – These are everything that the trustees hold for the pension scheme. They can include *investments*, bank balances and any amounts owed to the scheme.

Defined Benefit Pension Scheme – This is where the rules of the scheme decide how much pension the member will get. There are different ways of working out the size of the pension, but the member will know which system the scheme uses. The most common type of defined benefit pension scheme is a final salary scheme. A defined benefit pension scheme may include the defined benefit part of a hybrid scheme, for example a scheme that pays a combination of defined benefit and *defined contribution benefits*.

Defined Contribution Benefits – This is where the size of the member's pension is not decided by the rules of the scheme. The size of the member's pension will be affected by factors such as how much money is put into the pension fund for the member, how much the pension fund has grown and what annuity rate is available when the member retires. This type of benefits are also called money purchase benefits.

Indexation – This is a way in which compensation in payment is adjusted from time to time with reference to changes in the level of retail prices, and possibly subject to other legal provisions.

Insolvency Events – These are the insolvency triggers specified in the Pension Protection Fund legislation, further details of which can be found on the Pension Protection Fund website. By way of example, these events include a company entering administration, an order winding up a partnership and a bankruptcy order being made in respect of an individual.

Investments – This is when the money paid into a pension scheme is used to buy things like stocks and shares, bonds and properties. These are called investments.

Occupational Pension Scheme – This is a scheme organised by an employer to provide pension benefits for their employees.

Pensioner – This is someone who is getting a pension at the moment.

Retail Prices Index – The general index of retail prices (for all items) published by the Office for National Statistics.

Revaluation – This is the name used for increases in compensation in deferment, i.e. between the time the member leaves the scheme and the start of their compensation payment.

Trustee – For an occupational pension scheme set up under a trust, a trustee is a person or a company appointed to carry out what the trust must do. They must follow the laws that apply to trusts.

This glossary is adapted, with permission, from 'The A to Z of pension terms' by Plain English Campaign. For further definitions visit the 'Free Guides' section of their website at **www.plainenglish.co.uk**

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www.pensionprotectionfund.org.uk

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