

Appendix

Payments During The Assessment Period

Part 1 – Introduction

1.1 The Pension Protection Fund provides two levels of compensation:

- **100%** – this is for pension scheme members who immediately before the assessment date:
 - have reached their pension scheme’s normal pension age; **or**
 - irrespective of their age, are either:
 - receiving a survivors’ pension; **or**
 - a pension due to ill health;
- **90%** – this is for the pension scheme members who immediately before the assessment date:
 - are below the pension scheme’s normal pension age; **and**
 - not receiving a:
 - survivors’ pension; **or**
 - pension due to ill health.

1.2 Irrespective of which level of compensation the pension scheme member qualifies for, on entry to the Pension Protection Fund, they become subject to a mixture of:

- Pension Protection Fund rules; **and**
- pension scheme rules.

1.3 How and when the Pension Protection Fund’s rules apply depends on the pension scheme member’s status on the day before the assessment date, for example whether he was:

- an ‘active pension scheme member’, ie a person in pensionable service under the pension scheme;
- a ‘pensioner member’, ie a person receiving a present payment of pension or other benefits:
 - under the pension scheme; **or**
 - through the transfer of credits;
- a ‘deferred pension scheme member’, ie a person (other than an active or pensioner pension scheme member) with accrued rights under the pension scheme; **or**
- a ‘postponed pension scheme member’, ie a person who:
 - has reached the pension scheme’s normal pension age;
 - is entitled to present payment of a pension; **but**
 - has postponed payment of his pension.

1.4 The following examples illustrate the principle:

Example 1

Pensioner member

The pension scheme member has reached the pension scheme's normal pension age and is receiving a pension of £100 a week.

If the pension scheme entered the Pension Protection Fund, the pension scheme member is entitled to 100% compensation and may continue receiving £100 a week, subject to admissible rules.

More information is given in the *Admissible rules* section later in this appendix.

The pensioner's compensation, derived from post April 1997 service, will be increased each year in line with the Retail Price Index capped at 2.5%.

More information is given in the *Indexation* section later in this appendix.

Example 2

Deferred pension scheme member

The pension scheme member has not reached the pension scheme's normal pension age and is therefore not receiving a pension.

If this pension scheme member subsequently reached the pension scheme's normal pension age **after** the pension scheme entered the Pension Protection Fund then, subject to a review of the pension scheme rules, the pension scheme member could expect to receive the 90% level of compensation calculated using the Pension Protection Fund's rules.

Part 2 – During the assessment period

2.1 Introduction

Section 138 of the Act

2.1.1 During an assessment period, pension scheme trustees must pay pensions and benefits at a level that does not exceed the Pension Protection Fund level of compensation. It is expected that, in the majority of cases, payments are made at the Pension Protection Fund level of compensation. The requirements shown in this appendix should be applied when making payments.

2.1.2 The remainder of this appendix gives brief information on the following areas trustees may need to address during the assessment period:

- admissible rules;
- compensation levels;
- compensation cap;
- separate pension scheme lump sums;
- commutation of pension for a lump sum;
- revaluation;
- indexation;
- early payment of compensation;
- survivors and dependants;
- divorce and pension sharing;
- cash balance pension schemes;
- short-term pension scheme members.

2.1.3 More information can be found in the Pensions Act 2004 and its supporting legislation. Unless referred to otherwise all references to the Act, sections, schedules and regulations are those under the Pensions Act 2004 and will be shown in italics throughout the text.

For example, *Sch 7, s35* means *Schedule 7, section 35*.

2.2 Admissible rules

Sch 7, s35

2.2.1 When a pension scheme enters an assessment period, a review is undertaken of recent:

- **changes to pension scheme rules:** when pension scheme rules were made or took effect in the **three years** before the assessment date;
- **discretionary increases:** when an increase under the pension scheme rules in the rate of any pension in payment or postponed pension which were made or took effect in the **three years** before the assessment date; **and**
- rules that come into operation by reference to an insolvency event in relation to the employer or any associated event.

2.2.2 The Pension Protection Fund will treat as void any pension scheme rule which came into operation through the winding-up of the pension scheme or any associated event.

2.2.3 If the review establishes that immediately before the assessment date, the aggregate effect of recent rule changes and/or recent discretionary increases resulted in an overall increase in the pension scheme's liabilities (and hence the Pension Protection Fund's potential liabilities), then all of those rules and increases are to be disregarded by the Pension Protection Fund, leaving only those rules and increases which **are** permitted – the 'admissible rules'.

2.2.4 'Admissible rules' are therefore the rules that remain following the review – and which will be allowed by the Pension Protection Fund.

2.2.5 The Pension Protection Fund will ask trustees to carry out this review. The Pension Protection Fund will provide guidance on any technical issues that arise.

Pension scheme rules that are always admissible

Sch 7, s35(6) and (8)

2.2.6 The legislation gives information about pension scheme rules and discretionary increases allowed by the Pension Protection Fund. For example, the Pension Protection Fund permits rule changes relating to any:

- enactment; **or**
- changes in legislation.

Good practice

Sch 7, s35

Trustees should apply the admissible rules as soon as possible to prevent pension scheme members being paid incorrect amounts.

If admissible rules are identified and applied some months after the assessment date, adjustments can be made, by the Pension Protection Fund at the end of the assessment period if the Pension Protection Fund assumes responsibility for the pension scheme under *section 163 of the Act*.

*Admissible rules that result in total loss of both pension and compensation
Sch 7, s31*

2.2.7 If a pension scheme member is receiving a pension based on rules which the Pension Protection Fund decides are **not** admissible:

- the preceding rule automatically applies, if there is one; **and**
- the pension scheme member **may** not be entitled to immediate payment of compensation.

If there is no preceding rule, see the **Survivors** section later in this appendix.

Good practice

In all cases which involve loss of entitlement to compensation for **survivors**, the Pension Protection Fund would treat the survivor as entitled, under admissible rules, to compensation.

*Applying admissible rules to 'survivors'
Sch 7, s31*

2.2.8 When applying admissible rules to survivors, the Pension Protection Fund will only treat the survivor as entitled to present payment of his pension if the admissible rules result in a nil entitlement to present payment of compensation under paragraph 3 of Schedule 7.

2.2.9 The following example illustrates the principle:

Example

In:

- **2007**, the pension scheme introduces a new rule to provide survivors' benefits to unmarried partners;
- **2008**, the pension scheme member dies and the member's unmarried partner receives a survivors' pension in accordance with the new rule, made in 2007; **and**
- **2009**, the pension scheme enters an assessment period and the review does not admit the rule change.

As there is no preceding rule, the individual has no apparent entitlement to Pension Protection Fund compensation.

However, following the review of the pension scheme rules and application of the admissible rules, the unmarried partner will be:

- treated as entitled under the admissible rules; **and**
- eligible to receive compensation payments.

*Applying admissible rules to 'normal pension age' pension scheme members
Sch 7, s31*

2.2.10 After applying admissible rules, pension scheme members who are receiving a pension based on their pension scheme's normal pension age and will:

- continue to receive the present payment of pension if the pension **satisfies** the admissible rules; **and**
- become a deferred pension scheme member if the pension **does not satisfy** the admissible rules.

2.2.11 The pension scheme member's status is determined at the date immediately before the assessment date by applying the admissible rules of the pension scheme.

2.2.12 The following examples illustrate the principle:

Example 1

Admissible rules relating to pension scheme members of normal pension age – when a pension scheme member:

- *retains his present pension;*
- *will be a deferred pension scheme member.*

In:

- **2007**, the pension scheme introduced a rule change that reduced the normal pension age from 65 to 60;
- **2008**, two pension scheme members aged 65 and 62 retire under the 2007 rule; **and**
- **2009**, the pension scheme enters an assessment period and the rules review results in the disregard of all recent rule changes, including the 2007 rule change.

In this scenario, the preceding normal pension age of 65 applies automatically, and:

- in the case of the pension scheme member aged 65, he keeps his pension. This is because he satisfies the preceding rule, ie when the pension scheme member retired, he was aged 65;
- in the case of the pension scheme member aged 62, under the admissible rules of the pension scheme, he will become a deferred pension scheme member and will:
 - lose the present payment of his pension; **and**
 - have to wait until age 65 to receive payment of compensation – when the pension scheme member satisfies the rules of the pension scheme by reaching normal pension age.

Alternatively, the pension scheme member may be able to claim an early payment of compensation at a reduced rate.

More information is given in the **Early payment of compensation** section later in this appendix.

Any commuted amount will need to be taken into account when calculating future entitlement at the point of retirement.

Applying admissible rules to ill-health pension scheme members

2.2.13 When applying admissible rules to pension scheme rules relating to ill-health pensions and the pension scheme member does not satisfy the preceding rule then the pension scheme member will be deferred.

2.2.14 The following example illustrates the principle:

Example

In:

- **2007**, the pension scheme rules state that, to retire early on ill-health grounds, the pension scheme member must be incapable of doing **any** job (pension scheme rule 1);
- **2008**, the rule changes to allow pension scheme members to retire on ill-health grounds if they are incapable of doing their **existing** job (pension scheme rule 2);
- **2009**, a pension scheme member retires at age 40 on ill-health grounds, having satisfied the conditions of pension scheme rule 2; **and**
- **2010**, the pension scheme enters an assessment period and the rules review results in all recent rule changes being disregarded.

In this scenario the:

- pension scheme member has no entitlement to Pension Protection Fund compensation as the rule under which they retired is disregarded;
- trustees or manager would need to reassess the pension scheme member's entitlement against the rules that **are** admissible; **and**
- if the trustees or manager decide that the pension scheme member does not satisfy the 2007 rule then, for Pension Protection Fund purposes, the pension scheme member is a deferred pension scheme member and will:
 - lose the present payment of the pension; **and**
 - have to wait until to the pension scheme's normal pension age to receive payment of the compensation.

2.2.15 Alternatively, the pension scheme member could claim an early payment of compensation at a reduced rate.

More information is given in the **Early payment of compensation** section later in this appendix.

2.2.16 Any commuted amount will need to be taken into account when calculating future entitlement at the point of retirement.

2.2.17 The Pension Protection Fund may consider whether to carry out a review of ill-health pensions during the assessment period. More information on ill-health reviews is given in the Data Audit section of the Trustee Guidance available on our website.

Pension scheme member has already received a pension scheme lump sum or commuted lump sum

2.2.18 A pension scheme member may lose entitlement to present payment of pension under the admissible rules if they have already received a pension scheme lump sum or commuted lump sum.

2.2.19 In these cases:

- the pension scheme member is not entitled to any further lump sums; **and**
- any commuted amount must be taken into account when calculating future entitlement.

More information is given in the *Separate pension scheme lump sums* and *Commutation of pension for a lump sum* sections later in this appendix.

Good practice

When reviewing recent rule changes for pension scheme members who are **not** receiving a survivors' pension, the trustees or manager must determine if the pension scheme's normal pension age has changed in the three years before the assessment date. This is necessary because it is possible that the normal pension age may have been changed, in addition to other rule changes, and therefore will be amended by the application of admissible rules.

Early payment of compensation

2.2.20 Pensioner members who are deferred after admissible rules are applied may apply for early payment of compensation which will be payable at an actuarially reduced rate.

More information is given in the *Early payment* section later in this appendix.

Good practice

If a pension scheme member loses present payment of his pension, the trustees should immediately:

- make the adjustment; **and**
- notify the pension scheme member of the reason for the change.

This will limit any overpayment and ensure that the pension scheme member is kept fully informed of changes affecting the pension payment.

2.3 Changes in pension scheme member status during an assessment period

2.3.1 When there is a change of member status during an assessment period, for example a pension scheme member reaches normal pension age or a pension scheme member applies for a change in status, for example applies for early retirement, the trustees should:

- establish what the pension scheme member is entitled to under the pension scheme rules; **and**
- make any reductions that are necessary to ensure payments do not exceed the Pension Protection Fund level of compensation.

2.3.2 This ensures that no payments are made to which the pension scheme member is not entitled under either the pension scheme or the Pension Protection Fund – reducing the likelihood of the pension scheme member having to pay back any money to either the Pension Protection Fund or the pension scheme at the end of the assessment period.

Example 1

Pension scheme member applies for early retirement

The trustees should calculate the pension scheme member's pension entitlement under the pension scheme rules.

The trustees should then calculate what the pension scheme member would receive under the Pension Protection Fund. This would include the use of admissible (rather than pension scheme) rules, following Pension Protection Fund rules for revaluation from the assessment date and application of the compensation cap and the 90% rule.

The trustees should then bring into payment the lower of the two (this could be zero).

Example 2

Pension scheme member dies leaving unmarried survivor who applies for survivors benefit

The trustees should establish the entitlement of the survivor under the pension scheme rules.

The trustees should then establish the entitlement of the survivor under the Pension Protection Fund. In doing so, the trustees should assess not just how much the survivor would receive but whether the survivor meets the Pension Protection Fund qualifying criteria as set in regulations. For example, have they provided sufficient evidence to prove financial interdependence?

The trustees should then bring into payment the lower of the two (this could be zero).

Example 3***Pension scheme member applies for ill-health retirement***

The trustees should establish the entitlement of the pension scheme member under the pension scheme rules.

There is no Pension Protection Fund compensation payable in respect of an application for an ill-health pension made after the assessment date. Therefore, the amount the trustees could bring into payment will always be zero.

The pension scheme member should be informed of this and be provided with an explanation of the different options available, for example applying for early retirement. In particular, the pension scheme member should be made aware that, if the Pension Protection Fund does not assume responsibility for the pension scheme (for example the pension scheme is rescued), the pension scheme member may be entitled to the ill-health pension.

2.4 Compensation levels

100% / 90% compensation levels

2.4.1 Compensation is payable at two levels:

- **100%**; **or**
- **90%**.

2.4.2 The level payable depends, subject to admissible rules, on the pension scheme member's circumstances immediately before the assessment date.

Good practice

Trustees should apply the appropriate percentage levels as quickly as possible, in particular to those pension scheme members whose payments will be at the 90% compensation level. This will limit any overpayments.

If incorrect payments are made and the Pension Protection Fund assumes responsibility for the pension scheme, adjustments can be made, by the Pension Protection Fund, at the end of the assessment period.

More information is set out in Section 163 of the Act.

100% compensation level

2.4.3 Subject to admissible rules, the 100% compensation level is payable to pension scheme members:

- over the pension scheme's normal pension age;
- under the pension scheme's normal pension age who immediately before the assessment date are receiving an ill-health pension; **or**
- receiving a survivors' benefit.

2.4.4 The pension scheme members who are entitled to the 100% compensation level include:

- pensioner members, including those receiving survivors' benefit or an ill-health pension; *Sch 7, s3*
- postponed pension scheme members; **and** *Sch 7, s5*
- active pension scheme members over normal pension age. *Sch 7, s8*

2.4.5 In broad terms, this means the amount of compensation could equate to 100% of the pension in payment immediately before the assessment date (subject to the review of the rules of the pension scheme – the admissible rules).

90% compensation level

2.4.6 The 90% compensation level is payable to pension scheme members who immediately before the assessment date are:

- below the pension scheme's normal pension age; **or**
- who are below the pension scheme's normal pension age and have taken early retirement.

2.4.7 The pension scheme members who would be entitled to the 90% compensation level include:

- early retirement pensioner members below the pension scheme's normal pension age; *Sch 7, s3(7)*
- active pension scheme members below the pension scheme's normal pension age; **and** *Sch 7, s11*
- deferred pension scheme members. *Sch 7, s15*

2.4.8 Pension scheme members who are entitled to receive 90% compensation level are also subject to the compensation cap.

More information is given in the **Compensation cap** section later in this appendix.

Pension Protection Fund rules/pension scheme rules

Pension scheme rules – protected pension rate

2.4.9 Compensation is calculated at the **protected pension rate** for:

- pensioner pension scheme members; *Sch 7, s3*
- postponed pension scheme members; **and** *Sch 7, s5*
- deferred pension scheme members. *Sch 7, s15*

2.4.10 The protected pension rate is that calculated in accordance with the admissible rules of the pension scheme.

Pension Protection Fund rules – notional pension rate

2.4.11 Compensation is calculated at the **notional pension rate** for active pension scheme members:

- over normal pension age; **or** *Sch 7, s8*
- under normal pension age. *Sch 7, s11*

2.4.12 The 'notional pension rate' formula is:

Accrual Rate x Pensionable Earnings x Pensionable Service, ie **AR x PE x PS**

2.4.13 The following example illustrates the principle:

Example

- The pension scheme has an accrual rate of $1/60^{\text{th}}$ (**AR**)
- The pension scheme member:
 - earns £20,000 a year (**PE**);
 - has 10 years service (**PS**);
 - is entitled to the 90% level of compensation.

Applying the formula **AR x PE x PS** produces:

- $1/60^{\text{th}}$ (**AR**) x £20,000 (**PE**) x 10 (**PS**) = £3,333.3333
- 90% x £3,333.3333
- The annual amount of compensation is £3,000.00 a year

The calculation is subject to rounding, following the monthly payment calculation.

Accrual rate, pensionable service and pensionable earnings

Sch 7, s36

2.4.14 Pensionable service:

- includes:
 - actual service in any employment to which the pension scheme applies, which qualifies the pension scheme member for benefits under the pension scheme;
 - notional service allowed under the admissible rules, which qualifies the pension scheme member for benefits under the pension scheme, for example transfer credits (ie transfer of accrued rights from one pension scheme to another) are taken into account as 'notional' service under the new pension scheme;
- excludes service attributable to a pension credit.

Good practice

Trustees who cannot calculate a pension scheme member's entitlement on the Pension Protection Fund's rules must refer his case to the Pension Protection Fund assessment team, in the first instance, to determine the accrued amount.

Normal pension age

2.4.15 Normal pension age means the normal pension age under the pension scheme's admissible rules. The Pension Protection Fund has sought counsel's opinion on the definition of 'normal pension age'. This is available on our website on the FAQs for Industry Professionals page.

2.4.16 If the Pension Protection Fund accepts that it is not possible to identify the normal pension age under the admissible rules of the pension scheme, the Pension Protection Fund may use its powers under ***Sch 7, s34(3)*** to decide how to calculate the normal pension age.

2.4.17 If a pension scheme specifies different ages in relation to different parts of the pension or lump sums:

- treat the amounts as separate pensions or lumps sums; and
- take references to 'normal pension age' relating to a part of the pension or lump sum as the earliest age, under the admissible rules, at which that part becomes payable without actuarial adjustment. This excludes special provisions relating to early retirement on ill-health grounds or otherwise. *Sch 7, s34(2)(b)*

2.5 Compensation cap

Sch 7, s26 and the Compensation Cap Order

2.5.1 The compensation cap only applies to pension scheme members who qualify for the **90%** level of compensation.

2.5.2 The compensation cap is:

- specified in the *Compensation Cap Order*;
- £28,944.45 at age 65 for the 2006/2007 financial year;
- £27,777.78 at age 65 for the 2005/2006 financial year;
(Cap is applied at the point at which the compensation comes into payment or at the assessment date where the pension is already in payment)
- age related; **and**
- adjusted by the actuarial adjustment factors published by the Pension Protection Fund if the pension scheme member is above/below age 65.

For information about applying the compensation cap to multiple tranches of compensation, see the *Compensation Regulations*.

Applying the compensation cap

2.5.3 At its simplest, the application of the compensation cap means that, for pension scheme members who qualify for 90% level of compensation, £26,050 a year (2006 figures) is the maximum amount of compensation they can receive. This is because:

- the pension scheme member's entitlement is calculated in accordance with *Schedule 7*;
- £28,944.45 (2006 figure) is the amount specified in the *Compensation Cap Order*; **and**
- 90% of £28,944.45 is £26,050.005, rounded down to £26,050.

*Pension scheme members with entitlement to a periodic pension **and** a separate lump sum*

2.5.4 To apply the compensation cap to a pension scheme member with entitlement to a periodic pension **and** a separate lump sum:

Step	Action
1	convert the lump sum to a periodic pension by dividing the lump sum by the actuarial factor;
2	add the pension scheme member's actual periodic pension payment to the result of step 1 to obtain the total pension;
3	compare the: <ul style="list-style-type: none">• total pension obtained at step 2; and• compensation cap;
4	if the result is: <ul style="list-style-type: none">• lower than the compensation cap, then compensation is paid at this amount; or• more than the compensation cap, go to step 5;
5	calculate the cap factor by dividing the cap by the total pension
6	multiply the original periodic pension by the cap factor to provide an amount that takes account of the compensation cap;
7	multiply the original lump sum by the cap factor to provide an amount that takes account of the compensation cap;
8	reduce the results of steps 6 and 7 to 90%.

2.5.5 The following examples illustrate the principle:

Example 1

Applying the compensation cap to a pension scheme member with a periodic pension and a pension scheme lump sum, using the step-by-step guidance at paragraph 2.5.4

- pension scheme member aged **65**
 - periodic pension entitlement **£27,000**
 - lump sum entitlement **£67,500**
- (More information is given in the *Separate pension scheme lump sums* section later in this appendix)
- actuarial factor (for example purposes only) **15**
 - compensation cap **£28,944.45**

Applying the step-by-step guidance to the example figures:

Step 1	Divide the lump sum by the actuarial factor: $£67,500 \div 15 = £4,500$
Step 2	Add the actual periodic pension payment to the result of step 1: $£27,000 + £4,500 = \text{total pension} = £31,500$
Step 3	Compare the total pension with the compensation cap
Step 4	Total pension is more than the compensation cap, ie: $£31,500$ exceeds $£28,944.45$
Step 5	Calculate the cap factor: $£28,944.45 \div £31,500 = \text{the cap factor} = 0.9188714$
Step 6	Multiply the original periodic pension by the cap factor: $£27,000 \times 0.9188714 = \text{periodic pension} = £24,809.527$
Step 7	Multiply the original lump sum by the cap factor: $£67,500 \times 0.9188714 = \text{lump sum} = £62,023.819$
Step 8	Reduce the results of steps 6 and 7 to 90%: Periodic payment = $£24,809.527 \times 90\% = £22,328.57$ Lump sum = $£62,023.819 \times 90\% = £55,821.44$

Good practice

Section 163 of the Act

The trustees should apply the compensation cap as quickly as possible to those pension scheme members subject to the 90% compensation level. This will limit any overpayments.

If incorrect payments are made and the Pension Protection Fund assumes responsibility for the pension scheme, adjustments can be made, by the Pension Protection Fund, at the end of the assessment period.

Example 2

Applying the compensation cap to a pension scheme member with multiple tranches, using the step-by-step guidance at paragraph 2.5.4.

A pension scheme member is entitled to tranches of pension at age **60** and age **65**.

At age **60**:

- periodic pension entitlement **£12,000**
- lump sum entitlement **£36,000**
(More information is given in the *Separate pension scheme lump sums* section later in this appendix)
- actuarial factor (for example purposes only) **18**
- compensation cap (for example purposes only) **£20,800**

At age **65**:

- periodic pension entitlement **£15,000**
- lump sum entitlement **£45,000**
(More information is given in the *Separate pension scheme lump sums* section later in this appendix)
- actuarial factor (for example purposes only) **15**
- compensation cap (for example purposes only) **£30,000**

Applying the step-by-step guidance to the example figures, first at age **60** and then at age **65**.

At age **60**:

Step 1	Divide the lump sum by the actuarial factor: $£36,000 \div 18 = £2,000$
Step 2	Add the actual periodic pension payment to the result of step 1: $£12,000 + £2,000 = £14,000$ (total pension tranche at 60)
Step 3	Compare the total pension with the compensation cap
Step 4	The result is less than the compensation cap, ie: $£14,000$ is less than $£20,800$
Step 5	Calculate the cap percentage for use in assessing any later tranches: $£14,000 \div £20,800 \times 100 = \text{the cap percentage} = 67.308\%$ As the result is less than the cap, the pension scheme member will receive his lump sum tranche and commence his pension tranche at age 60, uncapped but subject to the 90% compensation level.

At age **65**:

Step 1	<p>Divide the lump sum by the actuarial factor:</p> $£45,000 \div 15 = £3,000$
Step 2	<p>Add the actual periodic pension payment to the result of step 1:</p> $£15,000 + £3,000 = £18,000 \text{ (total pension tranche at 65)}$
Step 3	<p>Compare the total pension with the compensation cap</p>
Step 4	<p>The cap percentage at age 65 is $£18,000 \div £30,000 \times 100 = 60\%$</p> <p>The total cap percentage is now 67.308% (from the age 60 calculation), plus 60% from the age 65 calculation, giving a total of 127.308%</p> <p>As this is more than 100, all future payments will be capped. This includes the periodic and lump sum amount coming into force at age 65 and the future payments of compensation in respect of the periodic compensation which was first payable at age 60.</p> <p>By the time the pension scheme member is 65, the amount of compensation which was £12,000 when it first came into payment at age 60 may have been increased as a result of annual indexation.</p> <p>For the purposes of this example, assume it is £13,000 a year at age 65.</p>
Step 5	<p>Calculate the revised cap fraction:</p> $100 \div 127.308 = \text{the revised cap fraction} = 0.78550$
Step 6	<p>Calculate the periodic pension. To do this:</p> <ul style="list-style-type: none"> • multiply the periodic pension payable from age 65 by the revised cap fraction = $£15,000 \times 0.78550 = £11,782.50$ • multiply the current periodic pension at age 60 by the revised cap fraction = $£13,000 \times 0.78550 = £10,211.50$ • add the two together = $£11,782.50 + £10,211.50 = £21,994$
Step 7	<p>Multiply the original lump sum at age 65 by the revised cap factor:</p> $£45,000 \times 0.78550 = \text{lump sum} = £35,347.50$
Step 8	<p>Reduce the results of steps 6 and 7 to 90%:</p> <p>Periodic payment = $£21,994 \times 90\% = £19,794.60$ Lump sum = $£35,347.50 \times 90\% = £31,812.75$</p>

2.6 Separate pension scheme lump sums

Sch 7, s5 + 10 + 14 + 19

2.6.1 If the admissible rules of a pension scheme offer its members a separate pension scheme lump sum, they become entitled to the separate pension scheme lump sum on their retirement.

More information is given in the **Admissible rules** section earlier in this appendix.

2.6.2 If a pension scheme enters the Pension Protection Fund, any such entitlement to a separate pension scheme lump sum may be reduced by the application of the:

- 90% compensation level; **or**
- compensation cap.

2.6.3 Also, if a pension scheme member is entitled to a separate pension scheme lump sum, he is not entitled to commute his pension in return for more than **one** lump sum. The following example illustrates the principle:

Example

At the assessment date, a pension scheme member:

- was receiving a pension; **and**
- had received a lump sum when the pension was awarded.

Following a review of the admissible rules, the pension scheme member's pension was revoked and they became a deferred pension scheme member.

When the pensioner retires at the pension scheme's normal pension age, they will not be entitled to receive a further commuted lump sum for the same pensionable service.

Good practice

If a pension scheme member received a lump sum before the assessment date, he will not be entitled to receive another lump sum for the same pensionable service.

2.7 Commutation of pension for a lump sum

Sch 7, s24 and the Compensation Regulations

2.7.1 The Pension Protection Fund publishes information on the factors the trustees should consider when commuting pension for a lump sum.

2.7.2 If a pension scheme has entered the Pension Protection Fund, commutation is one of the last things to be considered. The following example illustrates the principle:

Example

The pension scheme member's pension scheme is in the Pension Protection Fund and its normal pension age is 65.

When a pension scheme member retires, the Pension Protection Fund:

- calculates their entitlement in accordance with *Sch 7*; **and**
- applies the:
 - compensation cap; **and**
 - the 90% compensation level.

It is only after the application of the 90% compensation level that any request for commutation for a lump sum is calculated.

2.7.3 Under the Pension Protection Fund's rules, **retiring** pension scheme members can commute part of their periodical compensation in return for a lump sum, even pension scheme members who did not have this right under their pension scheme rules.

2.7.4 Commutation is only undertaken at the time of retirement, and is restricted to a maximum of 25% of a pension scheme member's pension entitlement. These restrictions, which are binding on pension schemes, are imposed by the *Finance Act 2004*.

Applications for commutation during the assessment period
Sch 7, s24

2.7.5 During an assessment period:

- pension scheme members may commute part of their periodic pension for a lump sum;
- pension scheme members may not commute on grounds of serious ill-health; **and**
- any request for commutation must be made in accordance with the pension scheme's process and timescales.

Good practice

Any request for commutation must be passed to the Pension Protection Fund if, at the end of the assessment period:

- a pension scheme member has opted for commutation;
- the trustees have not completed the necessary action; **and**
- the Pension Protection Fund assumes responsibility for the pension scheme.

2.7.6 If a pension scheme member is entitled to opt to commute part of his pension in return for a lump sum, he cannot get more than **one** lump sum for the same pensionable service. The following example illustrates the principle:

Example

At the assessment date, an ill-health pensioner:

- was receiving a pension; **and**
- had commuted part of his ill-health pension to a lump sum when it was awarded.

Following the review of ill-health awards, the pension scheme member's pension was revoked and he became a deferred pension scheme member.

When the pension scheme member reaches the pension scheme's normal pension age, he cannot commute any part of the pensionable service which was the basis of the earlier lump sum.

Good practice

If a pension scheme member received a lump sum before the assessment date, he is not entitled to receive another lump sum for the same pensionable service.

Trivial commutation

2.7.7 A member may commute his entire compensation entitlement under Pension Protection Fund rules if the amount payable is trivial.

The circumstances in which such commutation can occur is governed by the Finance Act 2004.

Trustees should refer to the Pension Protection Fund (Compensation) Regulations 2005, as amended, for detailed information but broadly speaking the situation is as follows.

A trivial commutation lump sum is payable by the Pension Protection Fund where:

- on the nominated date the value of the member's entitlement to Pension Protection Fund compensation and pension rights do not exceed the commutation limit which is 1% of the standard lifetime allowance (which is £1,500,000 for the tax year 2006-07);
- no trivial commutation has previously been paid to the member or such lump sum is paid before the end of the commutation period;
- it is paid when all or part of the member's standard lifetime allowance is available; and
- it extinguishes the member's entitlement to Pension Protection Fund compensation.

2.7.8 Calculating the value of a compensation entitlement

The value of member's compensation entitlement on the nominated day is calculated as follows

$$(\text{Periodic compensation} \times 20) + (\text{any lump sum compensation})$$

2.7.9 Calculating the value of pension rights

The value of the member's pension rights on the nominated day is the value of the member's relevant crystallised pension rights and uncrystallised rights on that date, as defined by the Finance Act 2004

2.7.10 Nominated date and commutation period

This the date nominated by the member. This can be any date in the 3 months up to and including the first day of the commutation period. If the member does not nominate a date the nominated date is the first day of the commutation period.

The commutation period is the period beginning with the day on which a trivial commutation lump sum or Pension Protection Fund trivial commutation lump sum is first paid to the member and ending 12 months after that day.

2.8 Revaluation

Sch 7, s12 and s16 and the Compensation Regulations

2.8.1 Briefly, the Pension Protection Fund level of revaluation is based on the percentage change in the Retail Prices Index in Great Britain, capped at 5% compound a year.

2.8.2 Revaluation applies to:

- active pension scheme members who were below normal pension age immediately before the assessment date; **and** *Sch 7, s12*
- deferred pension scheme members. *Sch 7, s16*

2.8.3 Revaluation is **not** payable to pension credit members. *Sch 7, s21*

Revaluation for active pension scheme members

2.8.4 Revaluation for active pension scheme members who were below normal pension age immediately before the assessment date is calculated using the Pension Protection Fund's rules.

Revaluation for deferred pension scheme members

2.8.5 Revaluation for deferred pension scheme members is calculated in relation to two revaluation periods:

- **first revaluation period** – this runs:
 - **from** the day **after** the pension scheme member left the pension scheme;
 - **to** the day **before** the assessment date;
- **second revaluation period** – this runs:
 - **from** the assessment date;
 - **to** the day before the pension scheme member reaches the pension scheme's normal pension age.

First revaluation period

2.8.6 The first revaluation period is calculated in accordance with the pension scheme's admissible rules.

More information is given in the ***Admissible rules*** section earlier in this appendix.

Second revaluation period

2.8.7 The second revaluation period is calculated using:

- the Pension Protection Fund's rules; **and**
- revaluation factors obtainable from the Pension Protection Fund.

2.8.8 To calculate revaluation for deferred pension scheme members:

Step 1	multiply the accrued amount by the 1 st revaluation factor to produce the 1st period revaluation amount (accrued amount x 1 st revaluation factor = 1 st period revaluation amount)
Step 2	add the accrued amount to the 1 st period revaluation amount to produce the 2nd period amount (accrued amount + 1 st period revaluation amount = 2 nd period amount)
Step 3	multiply the 2 nd revaluation amount by the 2 nd revaluation factor to produce the 2nd period revaluation amount (second revaluation amount x 2 nd revaluation factor = 2 nd period revaluation amount)
Step 4	add the accrued amount to the 1 st period revaluation amount and the 2 nd period revaluation amount to produce the new accrued amount (accrued amount + 1 st period revaluation amount + 2 nd period revaluation amount = new accrued amount)

2.8.9 The following example illustrates the principle:

Example

Calculating the revaluation for a deferred pension scheme member

- 1st period revaluation factor = 25%
- 2nd period revaluation factor = 50%
- accrued amount = £120.

The above figures are for illustration purposes only.

Applying the step-by-step guidance to the example figures:

Step 1	Multiply the accrued amount by the 1 st revaluation factor to produce the 1st period revaluation amount: £120 x 25% = 1 st period revaluation amount = £30
Step 2	Add the accrued amount to the 1 st period revaluation amount to produce the 2nd period amount: £120 + £30 = 2 nd period amount = £150
Step 3	Multiply the 2 nd revaluation amount by the 2 nd revaluation factor to produce the 2nd period revaluation amount: £150 x 50% = 2 nd period revaluation amount = £75
Step 4	Add the accrued amount to the 1 st period revaluation amount and the 2 nd period revaluation amount to produce the new accrued amount: £120 + £30 + £75 = new accrued amount = £225

2.9 Indexation

Sch 7, s28 and the Compensation Regulations

2.9.1 In brief, the indexation amount is:

- based on the annual Retail Price Index ending on 31st May;
- capped at 2.5%; **and**
- payable in respect of post 6 April 1997 service only.

Good practice

Pre and post 1997 service

If the pension scheme member's entitlement is 90% and subject to the compensation cap, apply indexation in the same proportions as if the 90% level and compensation cap did not apply.

If the pension scheme member commutes part of his periodic payment for a lump sum, apply indexation to the remaining periodic payment in the proportions that would have been attributed had commutation not taken place.

Indexation date

2.9.2 The indexation date is:

- the annual date on which a person is awarded indexation;
- 1st January each year.

2.9.3 Individuals are awarded indexation from 1st January after they first become entitled to periodic compensation.

Pension scheme member entitled to periodic compensation in the year before indexation date

Sch 7, s28

2.9.4 Briefly, indexation is payable based on $\frac{1}{12}$ ^{ths} of the indexation amount and is payable for each full month's entitlement in the 12 months that end on the indexation date.

Indexation and pension credit members

2.9.5 Indexation is payable on the compensation equal to pension credit benefit derived in respect of the pension scheme member's post 6 April 1997 service only.

2.10 Early payment

Section 138 of the Act

2.10.1 Provisions under the Act mean that, during the assessment period, benefits are payable to pension scheme members under the pension scheme rules, if they so allow, to enable them to take early retirement. But the Pension Protection Fund actuarial factors are likely to apply and the benefits will be reduced to the Pension Protection Fund level of compensation if necessary.

More information is given in the ***Change in status during the assessment period*** section earlier in this appendix.

Changes to early retirement age in 2010

Finance Act 2004, s279(1)

2.10.2 From 2010, the Finance Act 2004, Section 279(1) increases the age from which pension scheme members can take early retirement from **50** to **55**.

2.10.3 When these changes are introduced, the Pensions Act compensation regulations will be amended to take into account the requirements of the Finance Act 2004.

2.10.4 Pension credit members are **not** eligible for early payment of compensation – ***Sch 7, s15 and s19 by virtue of s21.***

2.11 Survivors and dependants

Sch 7, s4 + 6 + 9 + 13 + 18 + 22 + 23 and Compensation regulations

Spouses and unmarried partners

2.11.1 Compensation is payable to spouses and unmarried partners under the provisions of the Act providing there was provision (including discretionary provision) under the original pension scheme's admissible rules.

2.11.2 Compensation is now payable to civil partners under the provisions of the Act providing there was provision (including discretionary) under the original pension scheme's admissible rules to pay a survivor's pension to a spouse or civil partner.

2.11.3 In brief, compensation entitlement for a surviving spouse, a civil partner or an unmarried partner is payable as follows:

	No provision for survivor's pension	Provision to pay survivor's pension to a spouse	Provision to pay survivor's pension to a spouse or unmarried partner
Spouse	No compensation	50% of member's periodic compensation	50% of member's periodic compensation
Civil partner	No compensation	50% of member's periodic compensation	50% of member's periodic compensation
Unmarried partner	No compensation	No compensation	50% of member's periodic compensation

2.11.4 If compensation is payable to survivors, it is:

- usually paid:
 - for life – (for exceptions, see *Sch 7, s22*);
 - from the day following the pension scheme member's death – (for exceptions, see *Sch 7, s22*); **and**
- based on the pension scheme member's:
 - entire service;
 - annual periodic compensation.

2.11.5 If the scheme member dies before reaching normal pension age, the compensation paid to his survivor/estate is based on the compensation to which the scheme member would have been entitled at normal pension age but based on that member's actual service.

2.11.6 Where a member is married or in civil partnership, the compensation for survivors will be paid to the spouse or civil partner, unless a valid nomination has been made in

respect of an unmarried partner. Where the member has made a valid nomination in favour of his unmarried partner (and there is provision to pay a survivor's pension to an unmarried partner of the member under the admissible rules of the scheme) the unmarried partner will receive the survivor's compensation and the spouse or the civil partner will not receive compensation.

2.11.7 Indexation is payable on compensation for survivors in respect of service post 6 April 1997.

Evidence

Spouses

2.11.8 To qualify for compensation, spouses must provide a marriage certificate as proof of their marriage.

Unmarried partners

2.11.9 To qualify for compensation, unmarried partners must provide proof that they were:

- cohabiting with the pension scheme member at the date of his death, **and**
- financially dependent upon or interdependent with the pension scheme member.

Dependent children

2.11.10 Compensation is payable for children who, at the date of the pension scheme member's death, are:

Child	Evidence required by Pension Protection Fund	Pension Protection Fund compensation payable from...
Natural – born	Birth certificate	...the day following the pension scheme member's death
Natural – in womb	Birth certificate when child is born	...the child's date of birth
Adopted	Proof of adoption or a birth certificate with the adopted families details	...the day following the pension scheme member's death
Other children financially dependent on the pension scheme member at date of death	Such information as the Pension Protection Fund decides is appropriate	...the day following the pension scheme member's death

2.11.11 If requested, the Pension Protection Fund can advise about acceptable forms of evidence.

2.11.12 If a dependant is entitled to compensation under the Pension Protection Fund rules but not under the pension scheme rules, then no payment should be made during the assessment period. But if the Pension Protection Fund assume responsibility for the pension scheme, then the dependant will be entitled to Pension Protection Fund compensation, backdated to the assessment date – subject to a five year limit.

Age limit 18

2.11.13 Compensation is payable for a deceased pension scheme member’s surviving children until they reach age 18, but is payable up to age 23 in specified circumstances (or up to age 25 in those specified circumstances in respect of a child who was under age 25 on 5 April 2006 and who was entitled to receive compensation prior to 6 April 2006).

Age limit 25

2.11.14 Compensation is payable to an upper age limit of 23 years (or 25 years as detailed in 2.12.13) as follows:

Upper age limit	Conditional on the child being...	Evidence required by Pension Protection Fund
23 years	...in full-time education	Annual evidence from the educational institution
23 years	...in full-time vocational training	Annual evidence from the employer or institution
23 years	...unable to engage in full-time employment due to a condition defined as a disability under the <i>Disability Discrimination Act 1995</i>	Annual letter from doctor

2.11.15 If requested, the Pension Protection Fund will supply more detailed information about acceptable forms of evidence.

2.11.16 The Pension Protection Fund will allow a gap in education/vocational training of not more than 12 months. However, compensation is not payable during the gap.

Amount of compensation payable for surviving children

2.11.17 If there is a **surviving spouse or partner receiving survivors' compensation**, the amount of compensation payable in respect of surviving children is as follows:

Number of children	Compensation payable for surviving children
One child	25% of pension scheme member's periodic compensation
Two or more children	50% of pension scheme member's periodic compensation, divided equally

2.11.18 The situation is different if the pension scheme's admissible rules:

- provide compensation for surviving spouses or unmarried partners but such a pension is not in payment; **or**
- do not provide compensation for a surviving spouse/partner at all.

2.11.19 In these circumstances, the amount of compensation payable for surviving children is as follows:

Number of children	Compensation payable for surviving children
One child	50% of pension scheme member's periodic compensation
Two or more children	100% of pension scheme member's periodic compensation, divided equally

Good practice

Compensation for survivors will be adjusted if there is a change in circumstances.

Backdating limit

2.11.20 If a claim is made late, a backdating limit of five years applies.

2.12 Divorce and pension sharing

Section 220 of the Act

2.12.1 During the assessment period:

- current pension and divorce legislation applies; **and**
- pension credit members may be transferred out of the pension scheme, if appropriate.

2.12.2 The *Matrimonial Causes Act 1973* has been amended to require pension scheme members involved in a financial settlement on divorce or nullity to declare if:

- their pension scheme is in an assessment period, or
- they are receiving:
 - a pension at Pension Protection Fund levels; **or**
 - compensation (at the appropriate time).

Good practice

If the Pension Protection Fund assumes responsibility for a pension scheme at the end of the assessment period:

- the trustees must refer to the Pension Protection Fund any of the following which are not implemented:
 - pension sharing orders;
 - earmarking orders; **or**
 - attachment orders; **and**
- the Pension Protection Fund will then implement the order(s).

2.13 Cash balance pension schemes

Sch 7, s33 and the Compensation Regulations

2.13.1 Schedule 7 can be modified to pay compensation to pension scheme members of cash balance pension schemes as the characteristics of such pension schemes differ from those of traditional defined benefit pension schemes.

2.13.2 If pension scheme rules are unclear, regulations also allow Schedule 7 to be modified to enable the Pension Protection Fund to determine the accrued amount for:

- postponed pension scheme members *Sch 7, s5*
- deferred pension scheme members *Sch 7, s15 + 19*

Good practice

Trustees who cannot calculate a pension scheme member's entitlement based on the Pension Protection Fund's rules must discuss their case, in the first instance, with the assessment team member.

2.14 Short-term pension scheme members

Sch 7, s20 + 32 and the Compensation Regulations

2.14.1 Briefly, a pension scheme member is entitled to a lump sum payment at the 90% compensation level if:

- his service terminates due to the start of the assessment period; **and**
- all the following conditions are satisfied:
 - **he does not have** any Chapter 5 rights, ie statutory rights or, before April 2006 would not have Chapter 5 rights if Chapter 5 rights had existed; **but**
 - **he does have:**
 - unvested rights;
 - rights to a contribution refund or cash transfer sum under the pension scheme's admissible rules.

2.14.2 Compensation is payable to short-term pension scheme members as follows:

Entitlement under pension scheme's admissible rules	Pension Protection Fund provides...
Contribution refund only	... 90% compensation equivalent to a contribution refund
Cash transfer only	... 90% compensation equivalent to a cash transfer
Choice of contribution refund or cash transfer	... 90% compensation equivalent to the greater of the contribution refund or cash transfer
No payment	...no compensation

2.14.3 Regulations are in place to ensure that short-term pension scheme members cannot receive duplicate compensation for the same pensionable service.

2.14.4 Short-term pension scheme members whose service is terminated by the start of the assessment period will not receive compensation during the assessment period. This is because the pension scheme may be rescued and pensionable service awarded. These pension scheme members therefore only receive compensation if the Pension Protection Fund assumes responsibility for the pension scheme. *Section 160* of the Act.

Statutory right to a contribution refund or cash transfer
Sch 7, s32

2.14.5 If a short-term pension scheme member has Chapter 5 rights – statutory rights – to a contribution refund or cash transfer, or before April 2006 would have Chapter 5 rights if Chapter 5 had existed, he is treated as entitled to compensation in the same way as long-term service pension scheme members, ie:

- pensioner pension scheme members; *Sch 7, s3*
- postponed pension scheme members; *Sch 7, s5*
- active over normal pension age; *Sch 7, s8*
- active under normal pension age; *Sch 7, s11*
- deferred pension scheme members. *Sch 7, s15*