

Welcome...

... to our first edition of TN.

Our aim with each issue is to provide you with some practical guidance on topical and key issues that may affect schemes in Pension Protection Fund (PPF) assessment periods.



- + The Ilford judgment
- + Benefit Equalisation for GMPs
- + Terminal illness lump sums
- + Minimum pension age changes

- >P.01
- >P.02
- >P.03
- >P.04

→ News in brief	>P.05
+ Lump sum death benefits	
+ Negative RPI	



The Ilford judgment

Background and trustee proposal

The employer of the Ilford Pension Scheme (the “Scheme”) became insolvent leaving the underfunded Scheme potentially eligible for entry to the PPF. (Note, a qualifying insolvency event had yet to occur.)

As a whole, members would generally have received less through PPF compensation than they would have under the Scheme rules, particularly those members who had yet to reach normal pension age when the assessment period commenced. A provision in the Scheme rules (the “Buy-out Rule”) provided that the trustee could buy-out members’ benefits using scheme assets. A proposal was put forward, using this rule, which it was felt would help members of the Scheme should it enter the PPF.

In effect, a way of removing the effect of the benefit cut back for early retirees, by using scheme assets to buy those members’ benefits out in full and top up any shortfall that other members may incur as a result of the Scheme entering the PPF was put forward. The trustee sought directions from the Court on the proposal: specifically, whether it could put the proposal into practice.

The Judgment

Improper use of trustee power

The Court held that the proposal fell outside the scope of the power contained in the Buy-out Rule.

Support for this conclusion could be found in the requirement (in the Buy-out Rule) that the trustee should

take actuarial advice before deciding what amount was to be applied in the purchase of annuities. This was presumably, to ensure that no more than a fair “share of fund” is used.

Not a legitimate factor

The Court also held that the availability of PPF compensation was not relevant to the application of the Buy-out Rule. Building in the level of PPF compensation into future calculations was not a legitimate consideration in this situation – future PPF compensation is not an asset of the Scheme and could not be viewed in this way. The proposal was not consistent with the policy of the legislation establishing the PPF. The PPF is a safety net for underfunded schemes that would otherwise wind-up and produce much lower benefits than PPF levels of benefit.

The Court also held that the PPF is not to be exploited by manipulating scheme rules. PPF compensation could be a legitimate consideration in some circumstances. This could be, for example, when trustees are considering triggering an employer insolvency event. In general though, attempts by a trustee to take advantage of the PPF could be improper and would be likely to be set aside in most cases.

The impact of EC law?

Some thought was given to the impact of the EC Insolvency Directive. It was held that the existence of the PPF compensation cap was not contrary to the requirements of the directive. Although it did not express a view on the level of compensation itself, the Court did not close the door to further questions being raised.

The Ilford judgment (continued)

A further court case would be needed for any future claims to be brought however.

Other comments

The Court commented on the submissions that the PPF is a residual scheme beneficiary, whose interests were to be considered by the trustee. The Court's view was that the PPF is not a residual scheme beneficiary. The PPF did not exist when the Scheme was established and would only receive scheme assets if the Scheme transferred to the PPF and the trustee discharged from its obligations to pay benefits.

The Court also considered as well-founded, the PPF and the Pensions Regulator's concern that allowing this type of proposal to go ahead could open up the floodgates thereby imposing a severe strain on future PPF resources. If all schemes entering the PPF chose to adopt this approach, additional costs to the PPF and levy payers could exceed £350 million a year.

The representative beneficiaries have since applied for permission to appeal this decision (permission to appeal having been originally denied). We are still awaiting the outcome of that application.

What this means for trustees of schemes in assessment

Trustees need to be wary of proposals that seek to "game" the PPF. Certain proposals, which are dependent on a scheme eventually entering the PPF, will not be acceptable. Such proposals are not limited to the type put forward in this case. It could also, for example, affect proposals by a trustee board to take on an investment it would not otherwise take on if the PPF did not exist.

The Court accepted that there would be occasions where the existence of the PPF would be a legitimate consideration for trustees, for example, when considering whether to trigger an employer insolvency event.

Benefit Equalisation for Guaranteed Minimum Pensions (GMPs)

Background

Section 171 of the Pensions Act 2004 (the "Act") provides that the PPF must pay equal compensation to men and women.

Whilst the pensions industry has accepted that non-contracted-out scheme benefits and GMPs should be equalised in respect of service accrued since 17 May 1990, no guidance has ever been provided on how inequalities in scheme benefits arising from differences in the calculation of GMPs should be addressed.

Having received legal advice that the PPF's duty under section 171 extends to equalising inequalities in compensation arising from differences in the calculation of GMPs ("Benefit Equalisation for GMP"), the PPF issued a consultation document in April 2008 (the "Consultation Document") putting forward its views on how to meet this duty.

On 29 October 2009, the PPF published a "Decision Document" describing the approach it intends to take in relation to Benefit Equalisation for GMP.

Please note, the PPF is still finalising issues around the actual method of calculation and comparators.

Decision Document

General points

Section 171 requires the PPF to establish that a comparator (a person of the opposite sex doing like work of equal value) exists before making any adjustments for equalisation. The PPF is investigating this issue further.

The PPF must be certain that payments made before and after the assessment date are made on an equal basis.

The PPF does not intend to impose any new obligations on trustees of ongoing schemes – the proposals set forth in the Consultation Document relate only to schemes that enter an assessment period and are/have been contracted-out of SERPS with GMP entitlements accrued since 17 May 1990.

Equalisation methods

Trustees need take no action at this time, however, the Decision Document suggests two possibilities:

- establish comparators within the workforce and only equalise benefits where a comparator exists, or
- make a rule amendment to equalise benefits for all members with GMPs irrespective of whether a comparator has been found.

The PPF favours the latter approach. However, ultimately, this will be a matter for trustees to decide on (having taken appropriate advice) and in the light of any further information from the PPF.

Rule amendments

Any rule amendments would need to be made before the section 143 valuation is completed. This is because trustees completing a section 143 valuation must consider any inequalities in GMP calculations when working out the value of the compensation entitlements in respect of a scheme that may enter the PPF.

Trustees have expressed concern that this could create an unnecessary liability if the scheme does not transfer to the PPF at the end of the process. The PPF considers that, when the time comes, schemes could make these amendments contingent on entry to the PPF.

Benefit Equalisation for GMPs (continued)

The PPF is considering whether it would be appropriate to produce a standard deed of amendment.

Preferred method for Benefit Equalisation for GMPs

The PPF's preferred method is a partial application of method (2) as set out in Appendix B of the Consultation Document.

Broadly, this amounts to a comparison of pension between males and females at the assessment date, with the higher value taken.

Please note, the details of how equalisation for GMPs should be implemented are still being finalised. Further information will be provided when this has been achieved.

Regulatory guidance

The Pensions Regulator has agreed that equalising benefits in the way proposed by the PPF would be a "pragmatic way of addressing the difficulties of Benefit Equalisation for GMP" for schemes that ultimately transfer to the PPF as well as those that wind-up outside of the PPF.

The PPF has asked the Pensions Regulator to consider confirming this view in its own guidance.

Section 179 guidance

The PPF has decided not to alter the calculation of section 179 liabilities but will keep this under review.

What this means for trustees of schemes in assessment

No action is currently required from trustees until the PPF provides further guidance. Cases approaching a section 143 valuation should therefore, proceed in the usual way.

Stop press

DWP has stated that there will in fact be no need to identify comparators when equalising benefits for GMP where Financial Assistance Scheme cases are concerned. We will be making an announcement about how this will affect PPF cases in the near future.

Terminal ill health applications in a PPF assessment period

Introduction

The Pensions Act 2008 introduced new compensation provisions for the payment of terminal illness lump sums with effect from 1 April 2009.

The terminal illness lump sum is a commutation of future compensation entitlement in return for a lump sum of two times the annual amount of compensation that the member would have received and (if applicable) two times the amount of any lump sum they would have received.

The lump sum is converted using the relevant PPF actuarial factors.

Qualification for a terminal illness lump sum

To qualify for a terminal illness lump sum the following conditions must be met:

- the member must be suffering from a terminal illness (ie, an illness from which the member is unlikely to survive longer than six months),
- the member will become entitled to compensation on reaching the relevant age*,
- the member has not yet become entitled to any compensation, and
- the whole or any part of the member's lifetime allowance is available.

* 'Relevant age' is normal pension age or (if the member has opted for early payment of compensation or deferred payment of compensation) the age at which he will become entitled to compensation.

The application process

The member must make a written application. The member will also need to provide a lifetime allowance declaration.

The decision process

If the PPF is satisfied that each of the four conditions to qualify for a terminal illness lump sum is met the PPF must grant the application.

The PPF may hold over an application to a later date where, although the member has a progressive disease, he is likely (at the date of the application) to live for more than six months and all of the other conditions are met in respect of the member.

Successful applications

If an application has been granted the member will:

- qualify for a terminal illness lump sum, and
- lose the right to receive compensation on reaching the relevant age in relation to the scheme.

What this means for trustees of schemes in assessment

If scheme rules provide for a terminal illness lump sum, members of schemes in assessment, who meet any necessary criteria, will be entitled to the lower of the terminal illness lump sum that would be provided under the PPF compensation provisions and the terminal illness benefits provided under the rules of the scheme.

Minimum pension age and schemes in an assessment period

Introduction

The minimum pension age (MPA) is to rise from 50 to 55 with effect from 6 April 2010.

There are two key messages we want to relay to trustees of schemes in an assessment period:

- to remind them to let members know about the impending change to the MPA, and
- to be aware of the effect of a transfer notice on any pending early requirement requests.

What is changing?

With effect from 6 April 2010, other than in limited circumstances permitted by HMRC, the MPA will rise to 55. Pensions paid prior to this age, will be an unauthorised member payment and may incur a tax charge.

This is the case unless members have a protected pension age. A protected pension age is the age (under scheme rules in place on 10 December 2003) at which a member has an actual or prospective right to draw benefits earlier than at age 55.

The PPF rules for early payment of compensation will be changing to reflect the change to the MPA. The Department for Work and Pensions has published draft regulations amending the early payment rules (the Pension Protection Fund (Miscellaneous Amendments) Regulations 2010) and is currently consulting on those regulations. We await the outcome of the consultation.

What does this mean for trustees?

Trustees of schemes, whose rules currently allow for early retirement below age 55, should be aware that this change will take effect from 6 April 2010. Unless members fall into one of the exceptions above, if their request for early retirement has not been processed by 6 April 2010, they will not be able to draw their pension until they reach age 55.

Schemes in the assessment period

There is another consequence for schemes in the assessment period. Legislation provides that, at transfer, all defined benefit pension rights are extinguished. The effect of this is that any unprocessed requests for early retirement will also be extinguished.

All early retirement applications should therefore be processed before the scheme transfers to the PPF, as the applications will not transfer to the PPF as work in progress. Neither will the section 160 notice be postponed pending the process of any early retirement applications.

On transfer, the relevant member will have to apply to the PPF for early payment of compensation because an application for early payment of compensation cannot be made before transfer.

Trustees should consult their legal advisers if they require specific advice about the implications of the items covered in this article.

News in brief

Some changes in the following areas that have recently come into effect.

→ Lump sum death benefits

Power to treat lump sum death benefits as having become payable before the assessment date

The Pension Protection Fund (Miscellaneous Amendments) Regulations 2009

Previously, where a member died before the assessment period commenced, and during the assessment period a person became entitled under the scheme Trust Deed and Rules to a lump sum death benefit, legislation only allowed death in service benefits to be paid in the assessment period.

The Pension Protection Fund (Miscellaneous Amendments) Regulations 2009 extends this provision to all members allowing death benefits and contribution refunds to be paid during the assessment period (where the above circumstances apply).

→ Negative Retail Prices Index (RPI)

Negative RPI and its effect on PPF compensation

For the purposes of calculating PPF compensation where there are negative movements in RPI, compensation in payment will not be reduced as a result.

For members receiving compensation from the PPF, where the increase in the level of prices is zero, or negative, then compensation in payment will not be increased on the following 1 January. Accordingly the increase granted on 1 January 2010 is zero for pensioners.

PPF revaluation in deferment is also calculated by reference to the movements in RPI between the start of the assessment period and the day before the individual compensation comes into payment (subject to certain qualifications).

Where the movements in RPI for the whole revaluation period produce a negative figure, the revaluation amount would be zero. The PPF rules do not permit a negative revaluation of benefit.

Pensioners in payment whose schemes are in assessment will therefore receive increases at the rates provided by either their scheme rules or PPF compensation provisions – whichever is the lower.

The information we provide is for guidance only and should not be taken as a definitive interpretation of the law.

Relationships Team Technical Department
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If you have any queries, please contact us:

Tel: 0845 600 2541
Textphone: 0845 600 2542
Email: information@ppf.gsi.gov.uk