Key Points

- The Pension Protection Fund (PPF) provides compensation for members of defined benefit (DB) pension schemes whose sponsoring employers have become insolvent. It was established by the Pensions Act 2004.
- To qualify for entry to the PPF a scheme must be an eligible scheme. The Pension Protection Fund (Entry Rules) Regulations 2005 detail schemes that are not eligible.
- PPF entry is more complex for multi-employer schemes. The process will depend on the scheme's rules and whether or not the scheme is sectionalised or segregated (for example, on the insolvency of an employer). Detail is provided in the Pension Protection Fund (Multi-Employer Scheme)(Modification) Regulations 2005.
- The PPF is funded through levies on eligible DB schemes.
- If a scheme enters the PPF, the PPF will provide compensation to the scheme's members in place of their accrued pension. This compensation is subject to a cap which (usually) increases slightly each year.

Main Sources

- Pensions Act 2004 (Part 2)
- The Pension Protection Fund (Entry Rules) Regulations 2005
- The Pension Protection Fund (Compensation) Regulations 2005
- The Pension Protection Fund (Multi-Employer Scheme)(Modification) Regulations 2005
- The Pension Protection Fund (Reviewable Ill Health Pensions) Regulations 2005

The Pension Protection Fund

The PPF is a form of statutory protection for the members of DB pension schemes. It was established by the Pensions Act 2004 and came into existence on 6 April 2005. The PPF has a formal board made up of a chairman, chief executive and at least 5 other directors.

The PPF can provide compensation to members of DB schemes where the sponsoring employer is insolvent and the scheme has insufficient assets to provide benefits of at least equal value to the PPF compensation that would be payable. The Board of the PPF determines which schemes are eligible for compensation by applying detailed rules set out in legislation. Although the PPF provides compensation for all members of eligible schemes, there are limits on the amounts that are paid.

The board of the PPF works closely with the Pensions Regulator, as one of the Pensions Regulator's statutory objectives is to limit claims on the PPF. The board of the PPF also has responsibility for the Financial Assistance Scheme.

Entry

In order to qualify for entry into the PPF, a scheme must be an eligible scheme with a relevant deficit which has undergone a qualifying insolvency event. The occurrence of a qualifying insolvency triggers the start of an assessment period. This is a period during which the Scheme's trustees and their advisers work with the PPF to establish whether the Scheme is eligible for PPF entry and, if so, the level of benefits which will be used to determine the amount of PPF compensation that is payable

to members. Once a scheme has entered a PPF assessment period, there is no guarantee that it will qualify to enter the PPF (for instance if there is possibility of scheme rescue).

For a scheme to be eligible for the PPF:

- it must be a DB scheme (not a prescribed scheme or a scheme of a prescribed description);
- it must not have started to wind up before 6 April 2005;
- it must not be an exempt scheme (e.g. schemes with a Crown guarantee, schemes which are not tax approved (or tax registered from April 2006), schemes with fewer than two members, schemes providing death in service benefits only, schemes with fewer than 12 members where all members are trustees of the scheme, cross border schemes where the pension scheme in question is not UK registered, a superannuation fund as is mentioned in section 615(6) of the Income and Corporation Taxes Act 1988.); and
- the scheme's trustees must not have entered into an agreement to compromise an employer debt (except in very specific prescribed circumstances).

Multi-Employer Schemes

The treatment of multi-employer schemes depends on the way that the rules are drafted and whether or not they are sectionalised / segregated. Where a scheme is sectionalised, assets and contributions are allocated to a particular section and cannot be used for the purposes of another section.

A scheme's rules may also be drafted so that the scheme is subject to segregation on the insolvency of an employer: the proportion of the scheme's liabilities which are attributable to the insolvent employer and a corresponding share of the scheme's assets are segregated from the rest of the scheme's assets and liabilities. Scheme's rules can require segregation automatically or give the scheme's trustees the discretion to decide whether segregation occurs.

For a sectionalised or segregated scheme, each section/segregated part is treated as a separate scheme for the purposes of entry into the PPF. For schemes where the trustees have a discretion to segregate on an employer's insolvency, the PPF legislation deems the trustees to have exercised their discretion to segregate. The scheme is, therefore, automatically treated as if it is segregated. The result is that a scheme could enter the PPF on a piecemeal basis as individual employers become insolvent.

If a scheme is not sectionalised / segregated then the whole scheme will be eligible for the PPF only on the insolvency of the last remaining employer (i.e. a 'last man standing' scheme).

Funding

The PPF is funded through levies on eligible DB schemes. There are four types of levy:

- A scheme based levy, calculated using the scheme's liabilities and the number of members;
- An administration levy, calculated according to the number of scheme members and designed to fund the PPF's administration costs;
- A Pension Protection Fund Ombudsman levy which has not yet been levied; and
- A risk based levy. This has created the most concerns for sponsoring employers as the levy is calculated based on a scheme's underfunding risk (the amount by which a scheme's liabilities exceed its assets) and the sponsoring employer's insolvency risk (the likelihood of the sponsoring employer becoming insolvent). It is possible for scheme's to take steps to help reduce their risk based levy.

More information

Find out more about our Pension team at **gowlingwlg.com/pensions-uk**.
You can listen to or download the other episodes and get additional material at **gowlingwlg.com/pensionpodcasts**.
You can also stay up to date with the latest pension developments at **gowlingwlg.com/en/united-kingdom/insights-resources**.

Compensation

If a scheme successfully enters the PPF, the PPF guarantees that a certain level of benefits will be met. This is broadly, 100% of pensioners' benefits, up to a compensation cap of annual pension, and 90% of other members' benefits, again up to the same compensation cap. Not all increases to pensions (in deferment and in payment) would be covered: statutory minimum increases will be applied in deferment and payment to benefits applicable to service after 5 April 1997 (even if the scheme would have paid more generous increases) and dependants' benefits may not be paid in full.

Section 50 and Schedule 20 of the Pensions Act 2014 increase the compensation cap for individuals who receive PPF compensation and have more than 20 years of service with one employer. The compensation cap will rise by 3% for each year of service above 20 years with a maximum of double the standard cap. These provisions have not yet been brought in to force as changes were needed to secondary legislation.

The Government consulted on draft regulations in the Autumn of 2016 and is expecting the provisions relating to the long service compensation cap to be brought into force in April 2017. The draft regulations make some changes to Schedule 20 to address situations where tranches of compensation become payable on different dates, the intention being that pensionable service attaching to a second and subsequent tranche of benefits can be taken into account in calculating the long service cap.

There is also a more general change to the Pension Protection Fund (Compensation) Regulations 2005 to clarify that where a person has an entitlement to two different scheme payments, separate caps will be applied to each entitlement.

The compensation cap for 2016/17 is £37,420.42, 90% of which is £33,678.38.