

**EXPLANATORY MEMORANDUM TO THE
PENSION PROTECTION FUND (PENSION COMPENSATION CAP) ORDER
2005**

2005 No. 825

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.
- 1.1 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Description

2.1 The Board of the Pension Protection Fund is established by section 107 of the Pensions Act 2004 (c. 35) (“the Pensions Act”) to provide compensation for members of certain occupational pension schemes in the event of the insolvency of the scheme’s sponsoring employer and where the pension scheme is underfunded at a certain level.

2.2 The compensation cap is an amount used by the Board of the Pension Protection Fund to determine the amount of compensation payable to a person when it must be restricted in accordance with paragraph 26 of Schedule 7 to the Pensions Act.

2.3 This Order specifies the amount of the compensation cap.

3. Matters of special interest to the Joint Committee on Statutory Instruments

Use of affirmative procedure

3.1 This Order is made under powers in the Pensions Act and is subject to the affirmative procedure.

3.2 The use of the affirmative procedure is required by section 316(2)(s) of the Pensions Act. The power in paragraph 26(7) is relied upon to make an order to specify the amount of the compensation cap.

Provisions

3.3 Article 2 of this Order specifies that the amount of the compensation cap for the purposes of paragraph (a) of the definition of “compensation cap” in paragraph 26(7) of Schedule 7 to the Pensions Act shall be £27 777.78.

4. Legislative Background

- 4.1 This is the first use of the power under the Pensions Act 2004.
- 4.2 The Pensions Act 2004 established the Pension Protection Fund (PPF). The PPF will pay compensation to members of eligible occupational pension schemes where the sponsoring employer is insolvent and the scheme has insufficient assets to pay benefits at a level at least equal to the amount the PPF will provide.
- 4.3 The compensation cap is an amount used by the Board of the Pension Protection Fund to determine the amount of compensation payable to a person when it must be restricted in accordance with paragraph 26 of Schedule 7 to the Pensions Act

5. Extent

- 5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

- 6.1 Malcolm Wicks MP, the Minister of State for Pensions, has made the following statement regarding Human Rights:

In my view the provisions of the Pension Protection Fund (Pension Compensation Cap) Order 2005 are compatible with the Convention rights.

7. Policy Background

- 7.1 The Pensions Act establishes the Pension Protection Fund (PPF). The PPF will pay compensation to members of eligible occupational pension schemes where the sponsoring employer is insolvent and the scheme has insufficient assets to pay benefits at a level at least equal to the amount the PPF will provide.
- 7.2 This instrument places a cap on the level of compensation the PPF can pay to those individuals who, under the terms of Act, are eligible for 90% level of compensation (typically individuals under their schemes normal pension age at the start of the PPF's involvement with a scheme).
- 7.3 The amount of the compensation cap is £27,777.78 at age 65. The purpose of this figure is to achieve a cap which is effectively £25,000 when applying 90% level of compensation. When calculating a member's compensation the cap of £27,777.78 is applied before reducing the level of compensation to 90%.
- 7.4 The existence of a compensation cap and a limit on the amount

of compensation which will be payable by the PPF is intended to help prevent potential abuse of the PPF by ensuring that those higher earners, who may have influence over the management of a defined benefit pension scheme, are encouraged, by the amount of the compensation cap, to do all they can to ensure that their scheme remains out of the Pension Protection Fund.

7.5 The imposition of the cap will mean incentives to manipulate or take less care of the pension scheme will be significantly diminished.

7.6 Following consultation with Industry (including National Association of Pension Funds, Confederation of British Industry, Bank of England, Society of Pension Consultants etc) on a proposed salary cap, feedback received proposed a compensation cap ranging from £15,000 to £50,000. The amount of the compensation cap has been approved by HM Treasury.

8. **Impact**

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

9. **Contact**

9.1 David Shaw at the Department for Work and Pensions Tel: 020 7962 2464 or email: David.Shaw@dwp.gsi.gov.uk can answer any queries regarding this instrument.

31 January 2005