Appendix K: The Pension Protection Fund and Financial Assistance Scheme on divorce

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The Pension Protection Fund

Overview

K.1 The Pension Protection Fund (PPF) is a fund of last resort, set up to pay compensation to members of eligible Defined Benefit occupational pension schemes that fail and cannot meet their liabilities where the failure arose after 5 April 2005. (For pre-5 April 2005 failures, see the Financial Assistance Scheme, discussed in the next section.) It should be noted that the PPF is not there to provide compensation for Personal Pensions and other Defined Contribution funds which have fallen in value due to poor fund management.

K.2 Entitlement and payments made by the PPF are referred to as compensation rather than pension entitlements or payments. The PPF provides compensation in situations where there is a (qualifying) insolvency event in relation to the scheme's sponsoring employer and there are insufficient assets in the scheme to provide at least PPF levels of compensation.

K.3 Some very small pension schemes, for example those with fewer than 12 members, all of whom are trustees of the scheme, or those with just one member, are not eligible. Public-sector schemes including the Local Government Pension Scheme are not eligible. In part, PPF compensation is funded by a levy paid by all eligible pension schemes and in part from the funds of schemes that transfer into the PPF and recoveries made from the insolvent employer and/or pursuant to regulatory action, plus investment returns on those amounts. The PPF also manages the Financial Assistance Scheme, payments under which the PPF administers in its capacity as FAS scheme manager.

K.4 To qualify for entry into the PPF, the scheme's sponsoring employer must suffer a qualifying insolvency event (as defined in section 121 and section 127(3) of the Pensions Act 2004). Therefore, an insolvency practitioner will be appointed to deal with the winding up of the employer. One of the insolvency practitioner's responsibilities is to notify the PPF of the insolvency event. If the employer cannot suffer a qualifying insolvency event, to qualify for entry into the PPF the scheme's trustees must notify the PPF that the employer is unlikely to continue as a going concern.

K.5 When such an insolvency event occurs, or the scheme's trustees have notified the PPF that the employer is unlikely to continue as a going concern, the PPF must confirm whether the scheme entered an Assessment Period on the date of the insolvency event/notification. If the scheme has entered an Assessment Period, this will generally last around 2 years, but it can be longer where there are complications (for example, scheme litigation). During the Assessment Period, the scheme trustees are responsible for paying pensions but at PPF compensation levels.

K.6 If at the end of the Assessment Period an actuarial valuation confirms that the scheme cannot secure benefits at or above PPF compensation levels with an insurer, it will transfer into the PPF. The PPF must issue a transfer notice if the actuarial valuation shows that the scheme is underfunded, and the valuation has become binding. The scheme will automatically transfer to the PPF on the date of the transfer notice. If the actuarial valuation shows that the scheme can secure these benefits, then the scheme will leave the Assessment Period and the trustees must proceed to wind-up the scheme.

K.7 Schemes will not necessarily complete all stages of the PPF process. Some schemes will exit the Assessment Period early and continue as an ongoing scheme, for example, if the sponsoring employer is rescued as a going concern or the business is sold and another body takes responsibility for the pension scheme liabilities.

Pension scheme underfunding and insufficiencies

K.8 Pension schemes are under a statutory obligation to meet the minimum funding objective that is designed to ensure that schemes have sufficient funds to pay accrued benefits as they fall due. If an actuarial valuation shows that a scheme cannot currently meet this objective, it is said to be underfunded. In such circumstances, the trustees are required to work with the sponsoring employer to put a recovery plan in place, which involves the employer making exceptional / additional contributions over several years. The employer and the trustees may also agree to make benefit changes in order to reduce liabilities by amending the scheme rules. It is usually possible to reduce future service benefits without member consent (although statutory consultation requirements may apply), but generally it is not possible to reduce accrued benefits without member consent (under s67 of the Pensions Act 1995).

K.9 Pension scheme trustees can act to protect an underfunded scheme from members transferring benefits by reducing transfer values. Before they can take that step, the scheme's actuary must have provided an insufficiency report; but trustees are not obliged to reduce transfer values even if such a report is produced.

K.10 Although pension scheme underfunding may be cause for concern, the underlying consideration must be the strength of the employer's covenant and its ability to improve the scheme's funding over time. It would be incorrect to assume that every underfunded pension scheme, even those which are reducing transfer values, are necessarily heading for the PPF.

The PPF on divorce

K.11 Search facilities on the PPF website can be used to establish whether a pension scheme is in the Assessment Period or has transferred into the PPF. There is now a single table which covers schemes in assessment, and transferred schemes – https://www.ppf.co.uk/schemes/index . Those schemes that are in the Assessment Period are the most problematic in divorce cases owing to the inevitable uncertainty that will exist until the Assessment Period is concluded. During that period, the scheme will still issue CEs and Pension Sharing Orders can still be made and implemented by the scheme. The trustees have a choice as to whether to calculate a CE on the standard basis (in which case CEs are likely to be reduced for underfunding), or the PPF basis (by reference to the member's PPF compensation using PPF assumptions), and it will be important to clarify which has been used. Where the scheme is likely to transfer it makes more sense to use the PPF basis rather than the standard scheme basis. This is because the court needs to make a reasonable assessment of the member's pension benefits, and the member is likely to receive PPF compensation.

K.12 If a standard CE has been provided which has been reduced for scheme underfunding, a scheme cannot insist on an external transfer and must offer the option of an internal transfer too. If the ex-spouse requests an internal transfer, they will become entitled to PPF compensation in respect of their pension credit after the scheme has transferred to the PPF. In common with all PPF members, the ex-spouse will then not be able to transfer their PPF compensation to another pension scheme. In contrast, if the ex-spouse selects an external transfer, they will not be prevented from making onward transfers to other pension arrangements.

K.13 Those who were over their normal pension age when the Assessment Period started, or in receipt of a dependant's or ill-health pension, will receive 100% of their pension as at the assessment date as PPF compensation.

K.14 Those who were under their normal pension age when the Assessment Period started will receive 90% of their pension as at the assessment date as PPF compensation, subject to the PPF compensation cap. This applies to members who took early retirement before the start of the Assessment Period, and members who were active or deferred at the start of the Assessment Period.

K.15 For members who were active or deferred at the start of the Assessment Period, compensation will revalue during the period between the assessment date and normal pension age by the increase in the Consumer Prices Index capped at 5% (for PPF compensation relating to service accrued before 6 April 2009) and 2.5% (for PPF compensation relating to service on or after 6 April 2009). Compensation will be payable from the member's normal pension age, although compensation can be taken early, in which case it will be subject to actuarial reduction, or can be deferred, in which case it will be subject to an actuarial increase. On the member's retirement date, their compensation will be subject to the PPF compensation cap. As at April 2019, the standard cap for a member retiring at age 65 was £40,020 per annum, which after the application of the 90% restriction equates to a maximum compensation of £36,018 per annum. The standard cap is increased each year in line with wage inflation over the previous year. For those with 21 or more years' service in the original scheme, the standard cap is increased by 3% for each complete year in excess of 20, subject to a maximum equal to twice the standard cap (this is called the "long service cap").

K.16 Once in payment, any PPF compensation relating to service before 5 April 1997 in the original scheme does not increase. In contrast, PPF compensation relating to post-5 April 1997 service goes up at the rate of inflation subject to a cap of 2.5% per year, irrespective of what the original scheme would have provided.

K.17 PPF compensation can be shared or attached on divorce by making a compensation sharing or attachment order. The PPF will provide CEs on request. Contrast assistance under the Financial Assistance Scheme (see next section), which cannot be shared or be subject to the Pension Attachment Order.

The Financial Assistance Scheme

Overview

K.18 The Financial Assistance Scheme (FAS) is another compensation scheme for those who have lost out on their pension. Eligibility for the FAS is limited to Defined Benefit pensions schemes which meet all the following criteria:

- The scheme was underfunded and started to wind-up between 1 January 1997 and 5 April 2005, and
- The scheme did not have sufficient funds to pay members' benefits, and either
- The sponsoring employer cannot pay because it is insolvent, no longer exists or is no longer obliged to meet its commitment to pay its debt to the pension scheme

or

- The scheme started to wind-up after 5 April 2005 but is ineligible for compensation from the Pension Protection Fund owing to the employer becoming insolvent before that date.

K.19 The FAS closed to Notification and Qualification of new schemes on 1 September 2016.

K.20 For the scheme to qualify for the FAS, it was necessary for the application process to be started by notifying the FAS of details of the scheme. Trustees, professional advisers, members and surviving spouses or civil partners of deceased members of schemes that met the eligibility criteria were all able to notify the FAS. In the case of fully wound-up schemes, in addition to these categories of individuals, an insurance company providing annuities to former members was able to start the application process by notifying the FAS.

K.21 Once the FAS had been notified of the event, there was a qualification process during which the pension scheme provided the evidence required by the FAS Scheme Manager and eligibility for the FAS was checked. The FAS qualification process could take six months or more. Not all schemes completed the qualification process: some were unsuccessful. Once a scheme successfully completed the qualification process, the members became entitled to FAS assistance. All schemes which were notified to the FAS before 1 September 2016 have now completed the qualification process.

K.22 Before the final amount of FAS assistance due to eligible members had been calculated, the FAS Scheme Manager had the discretion to award initial payments to those members of schemes that had successfully completed the qualification process. The final amount of FAS assistance has now been calculated for all FAS schemes.

K.23 If the scheme purchased annuities for members during wind-up, members will receive a top-up payment from the FAS, in addition to their annuity (these are called "FAS top-up members"). If the scheme did not purchase annuities for members during wind-up, the assets of the scheme transferred to the FAS, and members will receive a single payment from the FAS (these are called "FAS single payment members"). All FAS schemes have now either fully wound-up or transferred to the FAS.

The FAS on divorce

K.24 The FAS website lists all schemes which have fully wound up or transferred to the FAS. See https://www.ppf.co.uk/sites/default/files/file-2018-11/list_of_fas_schemes-2.pdf .

K.25 A FAS top-up member will receive a maximum of 90% of the pension accrued in the original pension scheme, subject to a cap for any one FAS member (this is called "FAS standard assistance"). The cap applies to the combined total of any pension from the original scheme and the FAS assistance. For members whose entitlement began between 1 April 2019 and 31 March 2020, the standard cap is £36,103 a year. For those with 21 or more years' service in the original scheme, the standard cap is increased by 3% for each complete year in excess of 20, subject to a maximum equal to twice the standard cap (this is called the "long service cap"). The standard cap is revalued each year according to the increase in the Consumer Prices Index. A FAS single payment member will receive the greater of their FAS standard assistance, and the notional pension which the scheme could have afforded to secure for the member on the date of wind-up.

K.26 Assistance is paid from the normal retirement age of the original pension scheme but not before age 60. FAS standard assistance will increase from wind-up date to 30 March 2011 at the rate of the increase of the Retail Prices Index, up to a maximum of 5% per year. From 31 March 2011 to the normal retirement age, increases are at the rate of increase of the Consumer Prices Index up to a maximum of 5% per year. For most members, once FAS standard assistance is in payment, that part of the FAS standard assistance which accrued from April 1997 increases each year by the rate of increase of the Consumer Prices Index capped at 2.5% per year. The increases applicable to a FAS single payment member's notional pension will depend on what the scheme could have afforded to secure for the member on the date of wind-up.

K.27 Historically, if a Pension Sharing Order was made and it took effect before the scheme winding-up was completed or before the scheme had transferred into the FAS, it should have been implemented by the original pension scheme trustees. If a Pension Sharing Order was made and it took effect after the scheme wind-up was completed or transferred to the FAS, the trustees of the original scheme were not required to implement the order by sharing the pension holder's pension rights.

K.28 FAS assistance cannot be subject to Pension Sharing or Pension Attachment Orders but the FAS assistance can be considered when determining the extent of any orders against shareable pension rights and / or PPF compensation or as a resource generally. In addition, a Pension Sharing Order or Pension Attachment Order can be made in respect of annuities payable by insurers to FAS top-up members.