Implementing the European Court of Justice ruling

The ruling

The Court of Justice of the European Union (the CJEU) ruled in September 2018 that pension scheme members should receive at least 50% of the value of their accrued old age benefits if their employer became insolvent.

Affected members

Although the vast majority of PPF and FAS members already receive more than 50% of the value of their accrued benefits, there will be a small number of members who are affected by this ruling.

We expect that the members who are receiving less than 50 per cent of their entitlement will mostly be those whose PPF compensation or FAS assistance is capped and/or those for whom there is a difference between the indexation/revaluation rates that they were due in their original scheme, and in the PPF/FAS. There may also be other differences between scheme and PPF benefit structures.

We expect that those affected by the judgment who have been capped will typically be affected to a greater extent than those where the difference arises from indexation/revaluation rates.

What we are doing

Although the ruling is clear that members should receive at least 50% of the value of their accrued old age benefits, it does not provide complete clarity on *how* that is to be achieved. Ultimately we expect government will implement the ruling by introducing legislation. It is also possible that there could be further court rulings.

However, this could take some time. The CJEU ruling has direct effect on the PPF, so it is right for us to take action now. This document is a high-level explanation of our intended approach. It does not cover all the points of detail which still need to be worked out. We are working with the Department of Work and Pensions (DWP) to try to ensure that the approach we take is not only legally correct, but is also likely to be consistent with future legislation.

We are adopting a phased approach focusing first on capped pensioners (the group most likely to be substantially affected).

In October 2018 we started to write to capped pensioners who we believe may be affected by the ruling. This was to complete our records. Although we already hold the information we need to calculate PPF benefits and FAS assistance under the existing legislation, we do not retain all information about members' original schemes, so we are likely to need further information to be able to apply the 50% principle in individual cases.

At the same time, we are developing the process for how we will increase payments for those affected. See the section below and the illustrative examples for more information.

We are also talking to Trustees about how they should calculate and apply any increase to affected members of schemes in assessment.

The information we need

The letters that we are sending to pensioners explain the information that we need. The type of information we are asking for includes the pension increases that would have been applied under the original scheme, and what would have been paid to a spouse or partner in the event of a member's death.

This information might be found in communications or announcements from the scheme, or correspondence that members had with scheme administrators. If you are not sure whether information you have is useful, please send this to us so we can check.

Missing information

If you have not received a letter but think you are affected, you do not need to contact us. We will be sending letters in batches, and this may take some time to complete. Once we have written to capped pensioners, we will begin to contact members approaching retirement age who we believe will be capped, and then to any other members who we believe may also be affected.

If you don't have the information we ask for, we will consult other sources of information. For example we may get information from other members who were in your scheme.

Arrears

We will pay arrears to affected members. The time period in relation to which we pay arrears may be affected by time limits under the Limitation Act, although the Board will not without further notice treat time as continuing to run after the CJEU judgment, so no one will be prejudiced by not making a legal claim for arrears now. We are in discussion with DWP on this issue.

Interest

We will pay interest on the arrears.

Tax

Arrears and interest will be subject to tax in the usual way.

How we will calculate if an increase is due as a result of the judgment

In advance of legislation, we are putting in place an interim process to increase payments now:

For PPF members:

- To work out if a member is affected, we will assess the total actuarial value of the member's scheme benefits payable from the insolvency date, using their original scheme benefit structure (e.g. not subject to the PPF cap and using the original revaluation and indexation rates) and compare it against the total actuarial value of their PPF benefits (from the same date).

- If the total actuarial value of the member's PPF benefits is less than 50 per cent of the total actuarial value of their original scheme benefits, we will increase their level of PPF benefits until the actuarial value of their PPF benefits equals 50 per cent of the actuarial value of their original scheme benefits. This may mean that a member will initially receive more than 50 per cent of the pension they would have received from their scheme, because we have taken into account the differences between their scheme and PPF level of indexation and revaluation.

- The adjustment considered necessary to achieve the 50% minimum guarantee will be based upon a one-off valuation exercise, and will not be further adjusted (upwards or downwards) in the light of subsequent events.

- This approach means we can ensure members receive at least 50% of the value of their scheme benefits without having to change the levels of indexation as set out in the legislation for either PPF or FAS.

For FAS members

- We are the scheme manager for FAS on behalf of DWP and administer according to their instructions. Where we find FAS standard assistance is less than 50 per cent of the value of the member's original scheme benefits we will increase it (following a similar approach to that described for PPF members).

- For the time being, the process will only capture members of FAS insolvent schemes. This is because the directive applies to insolvent schemes and there is no legislation in place which would allow us to pay any increase to FAS members of solvent schemes. DWP is considering the action they may take on this point.

- A FAS insolvent scheme is a scheme where either the employer's insolvency took place before the date of scheme wind up, or the employer became insolvent after scheme wind up started while it still owed money to the Scheme or there was a deemed insolvency under FAS rules.

What actuarial assumptions we will use

To value the difference between scheme and PPF benefits, we will use our section 143 assumptions that were in force at the insolvency date. These assumptions are intended to reflect broadly the cost of securing the benefits with an insurance company. Both the scheme benefits and the PPF benefits are valued using the same assumptions, for consistency.

The following pages give two simplified worked examples of fictional members who are affected by the judgment. They show how we intend to calculate the increase to PPF benefits, where appropriate. They are to be used only as an illustrative guide to our intended approach.

We are finalising the methodology to be used, and working on guidance that will cover the actuarial methodology and some more complex scenarios (for example, how to treat survivor benefits) and further worked examples (for example where a pensioner took a lump sum), which we will publish in due course.

Example 1 – Mary, capped pensioner, PPF member
Example 2 – John, uncapped pensioner, PPF member

Example 1 – Mary, capped pensioner, PPF member

Mary's scheme pension

Mary was born on 1 January 1959. She took early retirement in 2014. Her pension scheme entered PPF assessment on 1 January 2018, when Mary was 59. The normal pension age for Mary's scheme was 65. Her scheme provided statutory levels of indexation[1]. The scheme did not provide any survivor benefits and Mary had no GMP entitlement.

Mary was receiving a scheme pension as at the assessment date as follows:

- Pre 1997: £25,000 per year
- Post 1997: £41,000 per year

Her total pension when her scheme went into assessment was £66,000 per year.

Mary's PPF compensation

Mary's pension was more than the PPF compensation cap, so when her scheme entered assessment, her pension was reduced to the PPF cap. The PPF cap on 1 January 2018 for a person aged 59 was £31,801.88 per year. She did not take a lump sum.

Because Mary was below her scheme's normal pension age, her starting compensation was further reduced to 90% of the compensation cap, or £28,621.69 per year. This was made up as follows:

- Pre 1997: £10,841.55 per year
- Post 1997: £17,780.14 per year

The split of her PPF compensation between pre 1997 and post 1997 was calculated by keeping the same proportions as her scheme pension.

Comparing the scheme entitlement and PPF compensation

To work out whether Mary is entitled to an increase in her compensation, the PPF first calculated the value of Mary's future scheme pension payments, at the date her former company went insolvent. They applied 'actuarial factors', which are used to value the future pension payments by using section 143 assumptions, which aim to estimate the cost of securing the pension with an insurer. The factors vary according to the level of indexation and so there are different factors for the pre and post 1997 service (recognising that it costs more to secure the post 1997 service with its higher levels of indexation). The factors used in this example are 22 and 33. (Approximate factors have been used in these examples. In practice, the factors to be used will be based on s143 assumptions as at the scheme's insolvency date, which can be found in the appropriate s143 assumptions guidance. Current and past versions of the guidance are available here.) The calculation was:

[1] Legislation dictates that pensions accrued before 6 April 1997 do not need to increase with inflation, except any part relating to Guaranteed Minimum Pension 'GMP' accrued between 6 April 1988 and 5 April 1997, which must attract inflation linked increases subject to a cap of 3% per year. It also says that pensions accrued after 5 April 1997 and before 6 April 2005 must attract inflation linked increases subject to a maximum of 5% per year. From 6 April 2005, they must attract inflation linked increases subject to a maximum of 2.5% per year. Before 2011 the relevant index was RPI, but since 2011 the relevant index has been CPI. In these examples, Post 97 means pension built up after 5 April 1997 and Pre 97 means pension built up before 6 April 1997.

(£25,000 x 22) + (£41,000 x 33)

This gave a total of £1,903,000 as the value of Mary's scheme pension.

Next the PPF calculated 50% of that value, or £951,500.

The PPF then calculated the overall value of Mary's PPF compensation payments, again, starting from the insolvency date. They again used 'actuarial factors', which in this example are 22 and 30. The calculation was:

(£10,841.55 x 22) + (£17,780.14 x 30)

This gave a total value of £771,918.30 as the total actuarial value of Mary's PPF compensation.

As this is less than 50% of what Mary would have expected under her scheme pension, she is entitled to an increase from the PPF.

Working out what increase Mary will get

To work out the increase due, the PPF takes each tranche of the PPF compensation (i.e. pre and post 97), and multiplies that by the factor of increase due. This factor is calculated by dividing half of what Mary expected to receive under her scheme pension, by what she would receive as PPF compensation:

- Pre 1997: £10,841.55 x (£951,500/£771,918.30) = £13,363.77 per year
- Post 1997: £17,780.14 x (£951,500/£771,918.30) = £21,916.57 per year

The total starting PPF compensation after this adjustment is £35,280.34 per year.

Because the PPF has taken into account the value of the indexation that would have been applied to the scheme pension in calculating the increase to the starting PPF compensation, there is no need for any further adjustments for indexation in future years.

What about arrears?

Mary is also due to be paid arrears. The monthly amount to be paid is calculated by finding the difference between the new starting compensation and the original starting compensation, and dividing by 12 as the number of months in the year:

£35,280.34 - £28,621.69 = £6,658.65 per year

£6,658.65/12 = £554.89 per month

As Mary has been receiving PPF compensation for 10 months, she will receive arrears based on 10 months' worth of the additional £554.89, plus interest.

Example 2 - John, uncapped pensioner, PPF member

John's scheme pension

John was born on 1 January 1967. He took early retirement in 2017 at the age of 50 (at his scheme's protected minimum age). The pension scheme, which he left in 1997, entered PPF assessment on 1 January 2018, when John was 51. The normal pension age for the scheme was 65. This scheme provided pre 1997 indexation at 5% fixed per year. The scheme did not provide any survivor benefits.

John was receiving a pension from his scheme as follows:

- Pre 1997: £20,000 per year
- Post 1997: nil

His total pension from this scheme when it went into assessment was £20,000 per year.

John's PPF compensation

John's pension was less than the PPF compensation cap, which was £26,179.39 per year for a person aged 51 on 1 January 2018 when the scheme entered assessment. So he was not affected by the cap. He did not take a lump sum.

Because John was below his scheme's normal pension age, his compensation was reduced to 90%, or £18,000 per year. This was made up as follows:

- Pre 1997: £18,000 per year
- Post 1997: nil

Comparing the scheme entitlement and PPF compensation

To work out whether John is entitled to an increase in his compensation, the PPF first calculated the value of John's future scheme pension payments, at the date of his former company's insolvency event. They applied an 'actuarial factor', which was used to work out the value of the future pension payments, which in this example is 44. (Approximate factors have been used in these examples. In practice, the factors to be used will be based on s143 assumptions as at the scheme's insolvency date, which can be found in the appropriate s143 assumptions guidance. Current and past versions of the guidance are available here.). The calculation of the factors took into account the future increases which would have been due under the scheme rules. The calculation was:

£20,000 x 44

This gave a total of £880,000 as the value of John's scheme pension.

Next the PPF calculated 50% of that value, or £440,000.

The PPF then calculated the overall value of John's PPF compensation payments, again starting from the insolvency date. They again used 'actuarial factors', which in this example is 24. The calculation was:

£18,000 x 24

This gave a total of £432,000 as the total actuarial value of John's PPF compensation.

As this is less than 50% of what John would have expected under his scheme pension, he is entitled to an increase from the PPF.

Working out what increase John will get

To work out the increase due, the PPF takes the PPF compensation, and multiplies that by the factor of increase due. This factor is calculated by dividing half of what John expected to receive under his scheme pension, by what he would receive as PPF compensation:

- Pre 1997: £18,000 x (£440,000/£432,000) = £18,333.33 per year
- Post 1997: nil

The total starting PPF compensation after this adjustment is £18,333.33 per year.

Because the PPF has taken into account the indexation that would have been applied to the scheme pension in calculating the increase to the starting PPF compensation, there is no need for any further adjustments for indexation in future years.

What about arrears?

John is also due to be paid arrears. The monthly amount to be paid is calculated by finding the difference between the new starting compensation and the original starting compensation, and dividing by 12 as the number of months in the year:

£18,333.33 - £18,000 = £333.33 per year

£333.33/12 = £27.78 per month

As John has been receiving PPF compensation for 10 months, he will receive arrears based on 10 months' worth of the additional £27.78, plus interest.

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