Briefing: Pension Schemes Bill – Pre-97 Rights in PPF / FAS

The PPF has a large surplus (£13bn). A small portion (£2bn) could fix a gross unfairness in the compensation rules that penalises people who saved into their pensions before 1997. This would benefit up to 400,000 pensioners. There would be no Exchequer cost. There would still be enough assets to ensure compensation levels were safe, and employers benefitted from elimination of the levy.

Introduction

The Pension Protection Fund (PPF) was established in 2004 and protects millions of members of defined benefit (DB) pension schemes.

If their sponsoring employer becomes insolvent, and there are insufficient funds in the scheme, the PPF pays compensation.

The Financial Assistance Scheme (FAS) protects members of schemes that failed before the PPF was set up (see final section for more on how FAS differs from PPF).

Level of compensation

The PPF does not protect 100% of the benefits that members build up in DB schemes. There are three main ways that PPF compensation falls short of the accrued DB rights:

(1) Anyone under pension age at the point of insolvency will only get 90% of their accrued pension (anyone over pension age or receiving an ill-health/survivor pension will get 100%).
(2) Compensation paid on pension contributions built up before April 1997 (pre-97 rights), is not eligible for cost of living increases and therefore declines in real terms every year.
(3) Compensation paid on pension contributions built up after April 1997 (post-97 rights) rises in line with inflation each year (subject to a cap of 2.5%).

The impact of the lack of inflation protection for pre-97 rights

About 80,000 PPF members only have pre-97 rights. This group receives no increases at all to what is often their main source of income which is eroded by inflation every year.

This was particularly acute during the recent cost of living crisis where this group lost about 10% of their purchasing power in just a year when inflation was at its peak. Anyone receiving compensation since 2005 is now getting 75% less in real terms.

The impact of the compensation rules for pre-97 rights is severe. Those with the majority or all of their pension accrued before 1997 are the worst affected.

Older members obviously have more service from before April 1997; statistics also show that women are disproportionately impacted too, this is indirect age and gender discrimination.

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The rationale for the lack of inflation protection for pre-97 rights

There were two reasons given for the lack of inflation protection for pre-97 accruals when this issue was originally debated in Parliament: (1) cost and (2) there was no legal duty on DB schemes to protect pre-97 rights.

While there was no statutory requirement for schemes to increase pre-97 rights, most did, and losing this protection in the PPF represents a significant (and disproportionate) loss. The real reason was cost; the government feared the levy on DB schemes would have to be set too high (or taxpayers would have to subsidise the PPF) if there was inflation protection for pre-97 rights.

Current funding position of the PPF

However the strong funding position of the PPF renders these concerns redundant. The 2023-24 annual report showed assets of £32.2bn available to meet expected liabilities of £18.8bn, a funding level of over 170%.

The PPF told the Work and Pensions Committee that giving pre-97 accruals the same inflation protection as post-97 accruals would increase expected liabilities by £2.2bn.

There are clearly enough funds to fix this unfairness. Compensation levels would not be at risk and employers would not end up paying. Up to 400,000 pensioners would benefit.

Sources of PPF funding

The very strong funding position is down to its impressive investment performance but is based on the members' assets that were transferred to the PPF and the employers' levies. Members and employers contributed to the surplus; both should benefit from it. The Bill has measures to allow the levy to be cut to zero, but nothing about improving compensation.

Why has government not acted itself so far?

In its recent response to a select committee recommendation about this, the government said: "Any change in this area has significant implications on public finances...".

However compensation would be funded by the PPF not the government and increases in compensation would be taxable, so the direct impact on public finances would be positive.

PPF liabilities are included in relevant measures of public debt. However, officials have not been able to explain how this improvement would impact on the government's fiscal targets or affect the government's fiscal headroom.

If government is not going to take this opportunity to use the large surplus in the PPF to fix an unfairness affecting up to 400,000 pensioners; it should, at least, explain why.

What would have to be done?

Schedule 7 to the Pensions Act 2004 precludes the Board from increasing compensation in respect of pre-97 accruals. This would have to be amended in the Pension Schemes Bill.

This Bill may be the only opportunity this parliament to fix this injustice.

How is the FAS different to the PPF?

FAS compensation is paid by taxpayers. There would be an impact on public finances for these members. But the PPF estimates that the taxpayer cost of giving FAS members protection for pre-97 accruals would be only £40m in total for the first five years.

This is less than the additional income tax revenue that would be collected from PPF and FAS members. So the net impact of these changes would still be positive for government revenue.

There are just under 300,000 members of the PPF, improving FAS compensation brings up to 140,000 more members in scope (average FAS compensation is much lower than PPF).