Hogan Lovells

Government amends definition of money purchase benefits

November 2011 Pension briefing

HIGHLIGHTS

In the aftermath of the decision of the Supreme Court in the *Bridge Trustees* case earlier this year, the Government inserted in the Pensions Act 2011 a change to the definition of "money purchase benefits", designed to ensure that it is not possible for money purchase schemes to develop funding deficits. Schemes that previously were money purchase may not be in the future. This Briefing Note looks at the implications for trustees of occupational pension schemes of the change.

WHY HAS THE GOVERNMENT CHANGED THE DEFINITION OF MONEY PURCHASE BENEFITS?

On 27 July 2011, in *Houldsworth v Bridge Trustees Limited and Department for Work and Pensions* (see box), the Supreme Court held that particular benefits under the scheme were money purchase benefits (**MPB**), despite having a guaranteed minimum investment return, and that pensions provided through internal annuitisation from defined contribution funds were also MPB.

The Department for Work and Pensions (DWP) issued a statement in the aftermath of *Bridge* pointing out that, as a result of the judgment, some schemes in which funding deficits can arise may be outside the protection of legislation on scheme funding, employer (section 75) debts and the Pension Protection Fund. The DWP stated that it intended to legislate as soon as practicable to provide certainty and protection for benefits, with retrospective effect from 1 January 1997.

The Government inserted an amendment to the Pensions Bill, to introduce a new definition of MPB. The amendment was passed and the Pensions Act 2011 received Royal Assent on 3 November 2011.

Bridge Trustees case

Houldsworth v Bridge Trustees Limited and Department for Work and Pensions involved a scheme originally set up as a defined benefit scheme, but which was restructured to provide top-up benefits in addition to the final salary benefits. The top-up benefits were "voluntary investment planning" (VIP) benefits and "MoneyMatch" benefits. Both were considered to be MPB at the time they were introduced. Pensions granted in the scheme by internal annuitisation were also considered to be MPB.

When the scheme was winding up, there was disagreement about the correct application of the statutory priority order for distributing the scheme's assets. In particular, questions arose about whether certain benefits in the scheme counted as MPB under section 181(1) of the Pension Schemes Act 1993, which defines MPB as: *"benefits the rate or amount of which is calculated by reference to a payment or payments made by the member or in respect of the member and which are not average salary benefits"*.

If the benefits were MPB, the assets fell outside the statutory priority order.

The case went all the way to the Supreme Court, the DWP intervening to argue that the benefits were not MPB. The Supreme Court ruled (by a majority) that the MoneyMatch benefits and the pensions granted by internal annuities were both MPB. (It had been decided at an earlier stage that the VIP benefits were MPB.) The requirement for MPB to be "calculated by reference to" contributions did not mean they had to be calculated *only* by reference to contributions. The definition was so wide that the promise of a fixed rate of investment return could qualify as a MPB, even if this led to a shortfall in assets compared to liabilities.

NEW DEFINITION OF MONEY PURCHASE BENEFITS

The new definition means that a benefit will be treated as a MPB if:

"its rate or amount is calculated solely by reference to assets which (because of the nature of the calculation) must necessarily suffice for the purposes of its provision to or in respect of the member".

The new definition goes on to say that a pension in payment will be treated as a MPB if:

"its provision to or in respect of the member is secured by an annuity contract or insurance policy made or taken out with an insurer" and, at all times before coming into payment, the benefit fell within the new MPB definition.

Income drawdown benefits, where a member has deferred buying an annuity and is receiving benefits through an income drawdown arrangement, will still be treated as MPB.

The new definition is retrospective to 1 January 1997 (broadly, to cover all schemes that have wound up since the Pensions Act 1995 came into force) but there will be transitional regulations to deal with schemes which are already winding up. The Government has also given itself power to amend the definition further and to make transitional regulations to cover situations such as where past decisions made by trustees on the basis of the previous definition cannot be revisited (for example, where winding up has been completed some time ago).

The transitional provisions may also deal with GMP underpins: this is not mentioned in the amendment nor was it an issue in the Supreme Court but the Court of Appeal in

Bridge held that where MPB include a GMP underpin, then the benefits are still money purchase. (The Court went on to decide that benefits accrued after 1997 were categorised as underpin benefits and therefore (unlike other MPB) they did nevertheless fall within the statutory priority order.)

WHAT THIS MEANS FOR PENSION SCHEMES

Schemes need to check whether the benefits offered by the scheme will fall within the MPB definition. For example, where a scheme promises a guaranteed return on members' contributions but the nature of the investments is that they might not attain that rate of return, the benefits under the scheme would not be MPB. In addition, if a money purchase scheme calculates benefits by reference to the value of members' accumulated funds, but pays the pensions directly from scheme assets (rather than using the funds to purchase annuities), then those pensions in payment will not be MPB.

Benefits that have in the past been treated as MPB but are not now covered by the new definition will have to comply with the regime applicable to defined benefit schemes, such as statutory regulation of funding, the rules on employer debts and the requirement to pay the Pension Protection Fund levy. Trustees will need to include the benefits in the triennial valuation process and, if they are in deficit, employers will need to make good the deficit.

A change of status from final salary to money purchase will also have other knock-on effects, given the various differences in detail between the legal compliance regimes applicable to each type of scheme (see box).

If your scheme has a non-standard benefit structure, you may want to contact us for advice on whether or not it is a money purchase scheme.

Key differences between occupational money purchase and final salary schemes

Occupational money purchase schemes (or the money purchase part of hybrid schemes) are:

- not eligible to enter the **PPF** and not liable for PPF levies
- not subject to the duty to report **notifiable events**
- not subject to **scheme-specific funding**
- not required to have (and have certified by the actuary) a **schedule of contributions** although most schemes must prepare a payment schedule with similar information
- exempt from the **employer debt** regime.

Other differences:

- **Deferred pensions** are subject to different revaluation requirements from those in final salary schemes.
- There are different rules about **increases to pensions** in payment. In particular, for money purchase schemes, pension increases do not apply for pensions coming into payment after 6 April 2005.
- The requirements about the information and material that schemes must **disclose** to new and existing members are not the same. Although trustees of both types of scheme have to provide members with basic information about the scheme as a matter of course, trustees of money purchase schemes must also send annual benefit statements to members and detailed information about options on retirement to members approaching retirement, including the right to ask the trustees to buy an annuity of the member's choice from an insurance company, while trustees of final salary schemes have to provide a summary funding statement.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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