Pension Bill 2011 fact sheet 2 – Government amendments to the definition of “money purchase benefit”

Following the Supreme Court’s judgment in *Houldsworth vs Bridge Trustees*, which was handed down on 27 July 2011, the Government has laid amendments to the Pensions Bill to clarify the definition of “money purchase benefit” in pensions law.

What was the Court case about?

The Imperial Home Décor pension scheme began winding up in 2003. The trustees of the scheme sought a direction from the Court, as it was unclear how to divide the scheme assets between members. One of the key questions was whether certain classes of benefit should be treated as “money purchase benefits”.

The Supreme Court decided that certain benefits **should** be treated as “money purchase benefits”, even though it was possible for them to develop funding deficits. For example, one class of benefits promised a rate of return related to a building society interest rate – but the underlying assets could not be guaranteed to deliver that rate of return.

Why is the judgment a problem?

Pensions law treats money purchase benefits differently from other benefits such as those offered by final salary schemes. A range of provisions exist to protect members of final salary schemes against the risk that their scheme is not able to meet the pensions promise – these include statutory regulation of funding, and the backstop of the Pension Protection Fund (PPF) if sponsoring employers become insolvent and schemes are underfunded.

The Government takes the view that the term “money purchase benefits” should only refer to benefits where there is no risk of a funding deficit. That is why the legislative protections for benefits such as final salary benefits do not apply to money purchase benefits.

If the Government had not acted following the judgment, members could find that their schemes were unable to pay their benefits – but they were still not eligible for help from the PPF. It could also have led to anomalous results when the assets of schemes in wind-up were distributed.

Why has the Government laid amendments now, rather than waiting for a future vehicle?

The Government recognises that this definition is a key building block in pensions legislation. It made a statement on 27 July setting out that it would legislate to clarify the definition. Pension schemes and professionals need clarity as soon as possible so that they know how to make everyday decisions involved in running a pension scheme.

What do the amendments do?

The amendments do four things:

- First, they ensure that the definition of “money purchase benefits”, only includes those benefits which cannot develop a deficit in funding;
- Second, they provide powers to make consequential or supplementary changes;
- Third, they provide powers to make transitional provision; and
- Finally, they provide a power to amend the definition of ‘money purchase benefit’ further.

The amendments will have retrospective effect to 1 January 1997. This is to ensure that, in broad terms, all schemes that have wound up since the Pensions Act 1995 came into effect, and particularly all schemes that have qualified for help from the Financial Assistance Scheme, can be treated fairly and consistently.

The Government recognises that the term “money purchase benefit” is used frequently in legislation, and that it may be necessary to amend other legislation in order to ensure it works correctly with the revised definition.

The Government also recognises that trustees and others may have had a different understanding of “money purchase benefit” in the past, and that it may be appropriate to make transitional provision where past decisions cannot practically be revisited. For example, it is unlikely to be appropriate to reopen the decisions made in relation to schemes that completed wind up some years ago.

What are the Government’s next steps?

The Government proposes to consult on regulations making consequential and transitional changes in due course.

It will encourage trustees and pensions professionals to look carefully at the new definition of “money purchase benefits” to understand how it will apply to their schemes, and to raise any concerns with the Government.

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Regulations would follow the affirmative procedure – that is, they would need to be debated by both Houses before coming into force. The Government believes this scrutiny is important on legislation that may have retrospective effect, and could amend primary legislation.

What does this mean for schemes?

Schemes need to check whether the benefits they offer will fall within the definition of “money purchase benefit” or not.

Some schemes offer “internal annuities” to members who have built up savings on a money purchase basis. That is, they offer to pay a rate of pension in return for the value of the rights the member has built up. Unless these promises are backed by insurance or annuity policies held in the name of the scheme’s trustees, they will not fall within the definition of “money purchase benefit”, as there is no guarantee that the lifetime cost of paying the pension is exactly the same as the value of the rights accumulated by the member.

Other benefits that could be affected would include schemes where there is a guaranteed investment return during the build-up phase on a benefit.

Any benefits that trustees have previously considered to be money purchase benefits, but would now fall outside the definition, will now be covered by the scheme funding legislation. This means that trustees will need to include these benefits in the triennial valuation process, and if they are in deficit, employers will need to make good the deficit. Schemes will also be subject to the Pension Protection Fund levy in respect of these benefits. Members may then benefit from PPF compensation in the event that the scheme’s sponsoring employer fails and the scheme is underfunded.