Briefing

BURGES SALMON

Pensions

May 2014

New DC definition: the transition

Importance: ★★★★

If you run a scheme with benefits considered to be DC, you should review them and assess whether they will satisfy the new definition of "DC" benefits (see box) coming into effect this July. The exact date has yet to be decided.

> ### New DC definition
>
> The new definition of DC is: *"benefits the … amount of which is calculated by reference to …payments made by the member or .. other person … and its …amount is calculated solely by reference to assets which (because of the nature of the calculation) must necessarily suffice for … its provision".*
>
> The intention is to be clear that a benefit is DC only where the asset and the liability always match.

As expected, the change in the definition will be backdated to 1 January 1997 (sic). This means you need to consider accrued benefits as well as future service.

In broad terms, benefits that are not DC in the new sense will in future be subject to the legislation applicable to DB schemes e.g. scheme funding, the employer debt and the PPF levy.

Extensive transitional easements mitigate many effects of the change, particularly in relation to accrued benefits. However, the impact on some schemes could still be considerable.

If your scheme has benefits that cease to count as DC, you should consider whether you want to amend them to return them to the DC side of the line. Changing them for the future will often be relatively straightforward but, depending on the nature of the benefits and the scope of a scheme's amendment power, alteration for the past could be more difficult. For example, the statutory protection for accrued benefits is likely to apply.

All that said, many DC schemes will be unaffected because their benefits already satisfy the tighter definition.

Benefits affected

Common forms of benefits that will cease to count as DC include:

- a DC style pot where the scheme rules guarantee a minimum return,
- a DC pot subject to a minimum level of DB benefit and the DB minimum proves higher and
- a DC "pot" that is entirely notional.

Back to 1997

The transitional easements are particularly important because the new definition is being backdated so far. Without them, many actions that were thought lawful at the time would have become unlawful. The government recognises this would have been unfair and could have led to substantial amounts of scheme money being spent unpicking history, often with little advantage to members.

The effect of most of the transitional measures is to validate past actions and to remove the need to revisit them. Others allow extra time to comply with requirements newly applicable to future service e.g. PPF levies.

The original proposal was for a lower level of validation from July 2011 when the Supreme Court made the decision that has led to the new definition. Trustees and employers will be glad that idea has been dropped from the final regulations.

The main reason for backdating is for the UK to live up to its obligations under EU insolvency and pensions law, and thereby protect taxpayers.

No blanket

Validation for past actions is broad but not blanket:

- generally, it is only available for certain types of benefit and
- the level of validation is different for different categories of benefit.

The transitional regulations can be thought of as dealing with five benefit categories. The table below outlines them and the relative levels of protection.

Where do your benefits stand?

For a feel of the protection for benefits already accrued in your scheme, you need to:

- understand whether they fit within the definitions of the benefits that have some protection (if not, see category 4) and
- look at the table for a guide to the general level of protection.

continued below

Definitions

These simplified definitions of the types of benefit with protection use the statutory term *money purchase* to mean DC in the new sense. They take a bit of getting used to.

A *cash balance benefit* is one that will be provided by a sum of money and there is a promise about the size of that sum (e.g. a minimum investment return), but no promise about the size of the eventual pension.

Cash balance underpin benefits are cash balance benefits to which a member is entitled only if they exceed a *defined benefit minimum*.

Money purchase underpin benefits has a corresponding meaning.

A *defined benefit minimum* is:

"(a) in relation to money purchase underpin benefits or cash balance underpin benefits, benefits which are not money purchase …, but which accrue … [over the same period] as the member's rights to money purchase underpin benefits or cash balance underpin benefits; or

(b) in relation to top-up benefits, a specified minimum … amount, where … a member is promised that the[ir]… rights to money purchase benefits or cash balance benefits will be at least equal to that … minimum…".

The references to cash balance benefits here are omitted for some purposes.

A *top-up benefit* is one to which a member is entitled where the amount of their money purchase benefits falls short of a *defined benefit minimum*.

Levels of transitional protection (TP)

"DC" refers to the new definition except in category 2 where it refers to the existing definition

Category of benefit		Level of TP
1	Benefits that are DC under new definition	No need for TP
2	Benefits held in the *Houldsworth* case* to be DC based on *the existing definition* ■ cash balance (CB) benefits ■ scheme pension (sometimes called self annuitisation) derived from - CB pots - DC pots	Highest TP
3	Common forms of benefit ■ defined benefit minimum to DC or CB underpin benefits ■ top-up benefits ■ scheme pension derived from the above ■ scheme pension derived from DC pots	Lower than category 2
4	Unspecified benefits treated as DC in the past and having some form of promise or guarantee other than as in category 3 *This is a sweeper category for unknown forms of benefit*	Lower again but still some TP (including on funding)
5	DB benefits	No question of TP

* It was the Supreme Court's decision in *Houldsworth* that category 2 benefits are DC under the existing definition that led to the need for a new one

The table gives you an idea of where your scheme stands. But in our experience, so various are the forms of "DC plus" benefit that schemes have, each one needs specific analysis to work out its exact position.

More information

If you would like more information, please get in touch with your usual contact in our pensions team or with **Richard Knight, Partner, Head of Pensions, tel: +44 (0) 117 939 2259 or email: richard.knight@burges-salmon.com**

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