Briefing

BURGES SALMON

Pensions

November 2013

New definition of DC benefits

Importance: ★★★☆

The change to the definition of DC (or "money purchase") benefits affects schemes with benefits that were previously considered to be DC but will cease to be DC when the new definition comes into effect.

The simplest example is a DC pot with a guarantee as to its amount e.g. a minimum investment return.

The definition is important because it is only schemes that, apart from death benefits, provide exclusively DC benefits that escape the statutory funding requirements and employer debt applicable to DB schemes.

But the change to the definition is going to be less disruptive than it might have been because it will have limited backdated effect in key areas like funding.

The DWP is working to bring the new definition into force on 6 April 2014 when, as planned since 2011, it will have retrospective effect to 1 January 1997 (sic). But wide exceptions will allow many past decisions on headline issues to stand.

Transitionals

The DWP has issued a consultation on draft transitional regulations setting out the exceptions. These are lengthy and complicated, and make April look optimistic as the start date.

The transitionals mean that in many respects the new definition will have exclusively future effect or will only be retrospective to 27 July 2011. That is when the Supreme Court decided the *Houldsworth v Bridge* case and the DWP declared its intention to redefine DC benefits.

Broadly, the new definition will apply:

- scheme funding - from 6 April 2014 onwards with no need to revisit the past,
- PPF eligibility and levy - from levy year 2015/16 onwards with no revisiting of the past, including levy bills,
- employer debt - trigger events after 27 July 2011 need to be reviewed and might require action, but earlier ones need not be revisited and
- winding-up - a winding-up begun before 28 July 2011 need not be revisited but any that began later and is complete by 6 April 2014 needs to be reviewed and might require action.

The final version of the transitional regulations is unlikely to be published until well into January at the earliest.

Definitions

The decision in *Houldsworth v Bridge* was that benefits could count as DC even though they could give rise to a deficit. The simplest example is a DC pot with a guarantee as to its amount e.g. a minimum investment return. The new definition (shown here in italics) makes clear that a benefit will be DC only where the asset and the liability always match:

"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."*

In future, it will also be clear that cash balance benefits are not DC as they have often been characterised.

Under the legislation, a pension is "cash balance" if (a) it will be calculated by reference to a sum of money and (b) there is a promise about the size of the sum but none about the amount of the pension. Many of the benefits ceasing to be DC as a result of the new definition will count as cash balance. A DC pot with a guarantee is one example.

This note refers to "affected benefits". A benefit is "affected" if it was previously believed to be DC and will not be under the new definition. A whole scheme is "affected" if (death benefits apart) this applies to all the benefits it provides.

Scheme funding

For scheme funding, the new DC definition has future effect only.

Where a whole scheme is affected, the scheme funding requirements will only apply from 6 April 2014 onwards. The scheme will be treated as a new one and funding documents will need to be created on the timetable applicable to such a scheme e.g. the first valuation must have an effective date within a year and must be completed within a further 15 months.

Where some benefits in a scheme are affected, there will be no need to revisit existing funding documents. The current cycle for valuations and funding documents can continue.

An existing schedule of payments continues in effect until there is a schedule of contributions to take over.

Employer debt

There is a watershed on 27 July 2011 for the employer debt. The DWP explains that its statement on that date put schemes on notice that the definition was going to change from then on at least.

Briefly, for trigger events before then there is no need to revisit what was done but later events must be re-opened.

- **Trigger event before 28 July 2011**

  Where a whole scheme that is affected had a trigger event before 28 July 2011 but the event was not recognised as such because the benefits were considered to be DC, there will be no need to revisit how the event was dealt with.

  Where a scheme with some affected benefits had such an event, there will be no need to revisit how it was dealt with as long as all liabilities treated as DC were met in full.

- **Trigger event after 27 July 2011 and before 6 April 2014**

  Where a scheme that included affected benefits had a trigger event in this window and no arrangement was made to redistribute liability, the employer debt must normally be recalculated to include the affected benefits. But this is unnecessary where the trustees think it would not improve recovery, or would involve disproportionate cost or take an unreasonable time.

  If a multi-employer scheme that included affected benefits had a trigger event in this window and liability was redistributed, the additional liabilities must be covered by an arrangement (the existing one or a new one) under the legislation that meets the funding test. If moves in this direction fail in specified ways, an employer debt is taken to have crystallised at the original date.

PPF eligibility and levy

In principle, the new definition has future effect only for PPF purposes.

Where a whole scheme is affected, it will be treated as first becoming eligible for the PPF in April 2015 (sic). It must submit a s.179 valuation by 31 March 2015 and pay the levy for the 2015/16 year.

Where some benefits in a scheme are affected, there will be no need to revisit past valuations and the PPF will not re-open past levy bills. But the PPF will be able to ask for an out-of-cycle valuation if it foresees a significant deterioration in a scheme's funding position.

Winding-up

Where a scheme with affected benefits began to wind up before 28 July 2011, there will be no need to revisit past decisions (whether or not winding-up is complete).

Where a winding-up that involved affected benefits began after 27 July 2011 and is complete by 6 April 2014, there will be no need to revisit decisions if certain conditions are satisfied. Roughly, these are that all liabilities were met in full or the trustees consider that any claim they have to an employer debt would not improve the outcome for members.

Revaluation

There will be no need to revisit revaluations where affected benefits accrued before 6 April 2014 have been uprated for deferreds as if they were DC e.g. by applying an interest rate or minimum investment return prescribed in the scheme rules.

For accrual after 5 April 2014 trustees are pointed towards using the flat rate method for cash balance benefits (although technically the choice of method will remain theirs). This means revaluing benefits for deferreds in the same way (if any) as benefits for actives are uprated. Depending on how a scheme has revalued cash balance benefits in the past, this might be a change.

The flat rate method will be renamed the "cash balance and flat rate method".

Indexation

There will be no need to revisit the statutory indexation of pensions in payment on 6 April 2014. This is so even where there is no indexation because a pension was previously understood to be DC.

Since January 2012 there has been no need to index new pensions derived from cash balance accounts.

Schemes will still need to respect their own rules on indexation.

In addition to the above, transitional arrangements are planned in a dozen or so other areas.

The consultation paper and draft regulations are available at: **https://www.gov.uk/government/consultations/definition-of-money-purchase-benefits-in-occupational-pension-schemes**

If you would like more information please get in touch with your usual pensions contact or with **Marcus Hellyer on 0117 902 7789 or at marcus.hellyer@burges-salmon.com.**

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