

## REDEFINING “MONEY PURCHASE”

---

### PENSIONS

The Pensions Act 2011 (the Act) received Royal Assent on 3 November 2011. The Act redefines “money purchase benefits” retrospectively from 1 January 1997. It also makes previously announced changes to:

- ◆ the state pension age;
- ◆ auto-enrolment ([see NEST and automatic-enrolment note](#));
- ◆ repayments of surplus to employers;
- ◆ the switch from RPI to CPI; and
- ◆ time-limits for the “moral hazard” powers of the Pensions Regulator.

#### NEW DEFINITION OF “MONEY PURCHASE BENEFIT”

The Act redefines “money purchase benefits” retrospectively with effect from 1 January 1997. A benefit will now be “money purchase”:

- ◆ “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*”;
- ◆ and, in addition, in the case of pensions in payment: “*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*”<sup>1</sup>.

The new definition is not yet in force and will not apply to schemes already wound up. There are powers for the Department for Work and Pensions (DWP) to make transitional regulations which may result in further exemptions.

#### BACKGROUND TO THE CHANGE – *HOULDSWORTH V BRIDGE TRUSTEES LIMITED*

In July, the Supreme Court handed down its judgment in the case of *Houldsworth v Bridge Trustees Limited*, as a result of which the statutory definition of “money purchase benefits” has been amended through the Act.

The Court held that the current definition of money purchase benefits in the Pension Schemes Act 1993 does not require a scheme’s assets to equal its liabilities. The current definition provides that money purchase benefits are benefits “*the rate or amount of which is calculated by reference to a payment or payments made by the member or by any other person in respect of the member and which are not average salary benefits*”. In the case, the DWP had (unsuccessfully) argued that schemes like the one in question which provided for a guaranteed rate of investment return for members, or which provided for internal annuities at retirement, were not money purchase schemes because their terms could give rise to a funding deficit. The Court held that the possibility of a funding deficit does not preclude benefits from being “money purchase” under the current definition.

The definition of “money purchase” is used widely in pensions legislation to exclude schemes from funding legislation, including statutory debts under s.75 of the Pensions Act 1995 (s.75 debts) and the application of Pension Protection Fund compensation and levies (PPF levies) and determine priorities on winding-up. The case arose as a consequence of uncertainties over the priority of benefits on winding-up.

In response to the decision, the Act narrows the definition of money purchase benefits to ensure that if benefits could cause a scheme to have a funding deficit, the scheme will not be classed as a money purchase scheme and will not be exempt from funding requirements.

#### EFFECT OF THE CHANGE

The new definition will have retrospective effect to 1 January 1997 but is not yet in force. Exemptions may be made under transitional regulations to be issued by the DWP.

Certain schemes that have until now been “money purchase schemes” will retrospectively cease to be money purchase schemes. Subject to any transitional regulations, statutory funding requirements, revaluation and indexation of pensions in payment, PPF levies and s.75 debts may retrospectively apply to such schemes. Benefits previously treated as money purchase benefits under hybrid schemes may need to be reclassified and funding obligations reviewed. Internally annuitised protected rights and additional voluntary contributions (AVCs) may need to be externally secured.

Trustees and employers may wish to seek legal advice to consider how the new definition may impact on their scheme.

---

<sup>1</sup> Italicised wording in this section is new language.

#### REPAYMENT OF SURPLUS FUNDS TO THE EMPLOYER

Section 251 of the Pensions Act 2004 was the cause of great debate among practitioners last year because it provided that a power to repay surplus to the employer would be lost unless the trustees of the scheme passed a resolution retaining it no later than 5 April 2011. The Act extends the deadline for the trustees to pass the resolution (to preserve the right to make a payment to the employer) to 5 April 2016. As three months' prior notice to the members is required, the effective deadline is now 5 January 2016.

The Act clarifies that section 251 only applies to those schemes which are not winding-up, and that the legislation does not affect administrative payments to employers. Schemes which have already passed a resolution will get a second bite at the cherry if need be, and those resolutions passed before the old cut off date will still stand if desired. Hopefully, this should settle the great debate.

#### THE SWITCH FROM RPI TO CPI

Since 1 January 2011, the minimum statutory indexation of pensions in payment and revaluation of deferred pensions has been based on the increase in the consumer prices index (CPI), rather than the increase in the retail prices index (RPI). Macfarlanes' [publication of January 2011](#) summarised the proposals contained in the DWP's (now closed) consultation on the matter.

For those schemes which apply RPI, the Act provides that they will be exempt from applying CPI in years when CPI exceeds RPI.

This change is also not currently in force. Certain public sector unions are judicially reviewing the DWP's decision to make the switch to CPI.

#### CONTACT DETAILS

If you would like further information or specific advice please contact:

##### HUGH ARTHUR

DD: +44 (0)20 7849 2946  
hugh.arthur@macfarlanes.com

##### CAMILLA BARRY

DD: +44 (0)20 7849 2238  
camilla.barry@macfarlanes.com

##### JANE MARSHALL

DD: +44 (0)20 7849 2059  
jane.marshall@macfarlanes.com

#### NOVEMBER 2011

MACFARLANES LLP  
20 CURSITOR STREET LONDON EC4A 1LT

T: +44 (0)20 7831 9222 F: +44 (0)20 7831 9607 DX 138 Chancery Lane [www.macfarlanes.com](http://www.macfarlanes.com)

This note is intended to provide general information about some recent and anticipated developments which may be of interest. It is not intended to be comprehensive nor to provide any specific legal advice and should not be acted or relied upon as doing so. Professional advice appropriate to the specific situation should always be obtained.

Macfarlanes LLP is a limited liability partnership registered in England with number OC334406. Its registered office and principal place of business are at 20 Cursitor Street, London EC4A 1LT. The firm is not authorised under the Financial Services and Markets Act 2000, but is able in certain circumstances to offer a limited range of investment services to clients because it is authorised and regulated by the Solicitors Regulation Authority. It can provide these investment services if they are an incidental part of the professional services it has been engaged to provide. © Macfarlanes November 2011