PPF TN Technical News

Issue 6 | September 2014

Pension Protection Fund

In this issue

Welcome…

…to **Technical News**, the Pension Protection Fund's (PPF) newsletter on topical issues including practical guidance for schemes in PPF assessment periods and Financial Assistance Scheme (FAS) qualifying schemes. Our aim is to provide you with regular updates about topics of interest. If there are any technical issues about which you would like to hear from us, please do submit a comment via our website here: **www.pensionprotectionfund.org.uk/Pages/Feedback.aspx**

Money Purchase Benefits – the 'Bridge Regulations'

Readers will be aware that s29 of the Pensions Act 2011 came into force on 24 July 2014, bringing in a new definition of 'money purchase' benefits. At the same time, two sets of regulations introduced transitional and consequential measures.

The new definition will mean that some benefits which have previously been treated as money purchase may not now satisfy the s29 definition. Such benefits are therefore potentially eligible to be protected by the PPF.

The two main types of benefit which are likely to be affected by the new definition are cash balance benefits where there is a guaranteed investment return and internally annuitised benefits – but note that transitional regulations may apply.

The Financial Assistance Scheme (FAS) is also subject to the amended money purchase definition. However, as a consequence of the transitional regulations, provided the trustees can evidence to the satisfaction of the PPF that the relevant benefits were treated as money purchase before the scheme began to wind up, these benefits may continue to be treated as such.

➜ Cash Balance Benefits

These are benefits where there is a sum available in respect of a member, and a promise over its amount, but there is no promise as to the level of pension that the sum will be converted into. The investment return, if any, is not linked directly to the performance of the underlying assets. These will not meet the definition of money purchase, and, subject to transitional regulations, will be eligible for PPF compensation.

Benefits that offer a guaranteed investment return in the accrual phase, for example a minimum investment return of 3% a year, may previously have been treated as money purchase.

Cash balance benefits which are transferred to the PPF should be converted to a level of PPF compensation using the methodology set out in our updated s179 guidance, which is available through the following link.

http://www.pensionprotectionfund.org.uk/TechnicalGuidance/Pages/GuidanceValidforPreviousPeriods.aspx

This methodology will be detailed in the s143 guidance once it's updated (expected to be this month). This explains how to value cash balance benefits, depending on whether or not there is a guaranteed investment return.

➜ Internally Annuitised Benefits

Where a member's money purchase pot has been converted into a scheme pension at retirement the resulting pension will not be money purchase, and so will be eligible to transfer to the PPF. Where the member has elected for a scheme pension with no attaching survivor's benefit, then the corresponding PPF compensation will also not have this contingent benefit. Similarly, where members have elected not to receive increases on any of their benefits, the corresponding PPF compensation will not receive increases (including benefits accrued post 1997).

➜ Transitional Regulations

For schemes that entered a PPF assessment period prior to 24 July 2014, the transitional regulations provide that the PPF can determine that benefits that are no longer money purchase using the new definition can continue to be treated as money purchase for PPF purposes. The PPF must be satisfied that:

- immediately before the assessment period began, the trustees treated the relevant benefits as money purchase, and
- it is reasonable to treat those benefits as money purchase. The PPF will require evidence from trustees in order to be satisfied that the benefits in question were treated as money purchase prior to the assessment period.

The PPF has a similar discretion in respect of internally annuitised AVCs where a scheme enters a PPF assessment period on or after 24 July 2014. The PPF may determine that pensions derived from money purchase AVCs can be discharged as if they were money purchase where the scheme pension comes into payment on or before 1 April 2015. Again, the PPF will require evidence from the trustees about how the benefits were treated prior to the PPF assessment period.

Underpins and Top-up Benefits

The regulations also clarify what is meant by money purchase underpins and top-up benefits and how they should be treated. The regulations confirm existing PPF practice in that where a top-up or underpin applies, it should form one benefit which will be either wholly money purchase or wholly non-money purchase depending upon which is more valuable on a scheme benefits basis (not the PPF benefits basis) at the relevant calculation date.

➜ Out of Cycle s179 Valuations and Updated s179 Guidance

The PPF has the discretion to direct trustees to obtain and provide an out-of-cycle s179 valuation for a scheme that was previously eligible for PPF protection but which will see a new element of its benefit structure falling within PPF protection as a result of the changes to the definition of 'money purchase benefits'. The PPF ran a six week consultation earlier this year about this.

The PPF expects that it will,in practice, direct trustees to provide an out-of-cycle s179 valuation only where:

- a scheme's section 179 held on Exchange on 31 March 2015 would not otherwise take account of the new definition of money purchase benefits, and
- the result of the scheme's latest s179 valuation would have been materially different if the amended definition of money purchase benefits had been applied. For this purpose, 'material' means an increase in the latest s179 valuation's deficit or a reduction in the latest s179 valuation's surplus that is more than 10% in relative terms and is more than £5m in absolute terms.

The PPF will be writing to all schemes currently eligible for PPF protection to explain its policy on out-of-cycle valuations.

The PPF has updated its section 179 valuation guidance to take account of benefits affected by the new definition of money purchase benefits.

➜ Newly Eligible Schemes

It may be that some schemes which were not eligible for PPF protection will become eligible now that the s29 definition is in force. Such schemes will not previously have submitted a s179 valuation or paid a levy. They will become eligible for PPF protection from 1 April 2015.

In order that such schemes may be invoiced for the levy year commencing 1 April 2015, they must submit their first s179 valuation on the Pensions Regulator's Exchange system on or before 31 March 2015. The s179 valuation must have an effective date between 24 July 2014 and 31 March 2015.

Things to Watch...

Defined Ambition

The Government published its proposals to reinvigorate workplace pensions in its November 2013 consultation, Reshaping Workplace Pensions for Future Generations. The consultation document proposed a number of options to enable sharing of the risks associated with future pension provision. In its consultation response, published on 25 June 2014, DWP indicated that it does not intend to pursue some of the proposals that would have allowed more flexible defined benefit arrangements. However, the Government has concluded that there is support for some of the other risk-sharing models and plans to make legislative changes to create a risk-sharing space in the pensions landscape. To this end, the Pension Schemes Bill was introduced in the House of Commons on 26 June 2014. The Bill:

- Introduces definitions of 'defined benefits scheme', 'shared risk scheme' (sometimes referred to as 'defined ambition') and 'defined contributions scheme'. The definitions are based on the type of promise that members have during the accrual phase about the level of retirement benefit they will receive.
- Establishes a framework for providing 'collective benefits'. Assets of collective schemes are pooled and members are provided with a target benefit which they can expect to receive (although it is not guaranteed). An actuary certifies periodically whether the target benefit is likely to be met.

Collective schemes will not be eligible for the PPF.

The detail about how collective schemes will operate, and what regulation will apply to the various categories of pension schemes, will be set out in secondary legislation.

PPF Entry Rules

Amendments to the PPF entry rules came into force on 21 July 2014. The amendments follow the Court of Appeal decision in the Olympic Airlines case in June 2013. The Court's decision meant that the scheme's sponsoring employer, Olympic Airlines SA, had not experienced a qualifying insolvency event for PPF purposes so the scheme could not gain entry to the PPF. The Government undertook to review the position.

The amendments that have been made to the Pension Protection Fund (Entry Rules) Regulations 2005 are very tightly prescribed and will only apply until 21 July 2017. They create a new type of insolvency event for PPF purposes. A 'European insolvency event' will be triggered if:

- a scheme's sponsoring employer was on 20 July 2014 subject to ongoing insolvency proceedings in an EEA state other than the UK
- the employer has its main centre of interests in that state
- a winding-up order in relation to the employer was granted by the UK court, but set aside because the court did not have jurisdiction to wind up the company on the basis that the employer did not have an establishment in the UK, and
- a PPF assessment period would have been triggered by the winding-up order if the order had not been set aside.

The European insolvency event occurs on the fifth anniversary of the start of the overseas insolvency proceedings.

Budget 2014

Following the announcement in the March 2014 Budget that individuals with defined contribution (DC) savings will have greater choice about how to access those savings from April 2015, HM Treasury launched a consultation on 'freedom and choice in pensions'. One of the issues in the consultation was whether defined benefit (DB) to DC transfers should be banned. HM Treasury was concerned about the possible impact on financial markets if there was a large volume of transfers out of DB schemes. In the consultation response, published on 21 July, the Government confirmed that transfers out of private sector DB arrangements will continue to be permitted. Any member wishing to transfer out of a DB scheme will be obliged to obtain advice from an authorised IFA. The government will work with the Pensions Regulator to produce guidance for trustees on the use of trustees' existing powers to reduce transfer payments if the scheme is underfunded or delay a transfer in certain circumstances.

The Government has also said that it intends to consult on whether the requirement to transfer first to a DC scheme should be removed for those private sector DB members who wish to take advantage of the new flexibilities (i.e. allowing full or partial withdrawals direct from DB schemes).

The increased flexibilities for DC arrangements, and the associated changes that have been announced, will be implemented through amendments to the Pension Schemes Bill and a new Pensions Tax Bill. The changes will take effect from April 2015.

Finance Update

➜ Watch out for the new Pension Scheme Accounting Standard

There is a requirement in Regulations[1] that schemes obtain audited annual accounts. These Regulations specify that scheme accounts should contain a statement that they have been prepared in accordance with the Statement of Recommended Practice (SORP) issued by the Pensions Research Accountants Group (PRAG) in force at the scheme's accounting date or, if not, an indication of where there are any material departures from the SORP.

PRAG is due to issue a revised SORP later this year. The consultation period for the Exposure Draft of the revised SORP has now closed, but you can still access the Draft here:

http://www.prag.org.uk/12/text/1/files/PensionSORPExposureDraft.pdf

The new SORP is expected to apply to accounting periods beginning on or after 1 January 2015.

The new SORP will make a number of substantial and important changes to pension scheme accounts to bring them in line with the new UK accounting standards issued by the Financial Reporting Council, particularly FRS102. Two of the most noticeable changes are:

Annuity policies: many trustees hold annuity policies which guarantee some or all benefits payable to members. Previously, pension scheme accounts had to note the existence of such policies, but trustees were not required to assign a value to them. FRS102 removes this exemption, and trustees will be required to obtain annuity valuations. The revised SORP will make recommendations on valuation methods.

Investment risk and fair value hierarchy disclosures: FRS102 requires entities to make new disclosures on risks arising from financial instruments, and on the approach to determining the fair value of financial instruments. The new SORP will make recommendations, and give examples, of how to apply these requirements to pension scheme investment portfolios.

The PPF supports these changes, which will improve the quality of the financial information available to the PPF for both PPF-eligible schemes paying protection levies, and for schemes in PPF assessment.

1. The Occupational Pension Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996.

The information we provide is for guidance only and should not be taken as a definitive interpretation of the law.

PPF Technical Team, September 2014.

If you have any queries, please contact us:
Tel: 0845 600 2541
Textphone: 0845 600 2542
Email: information@ppf.gsi.gov.uk