EXPLANATORY MEMORANDUM TO

THE PENSIONS ACT 2011(TRANSITIONAL, CONSEQUENTIAL AND SUPPLEMENTARY PROVISIONS) REGULATIONS 2014

2014 No. 1711

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument together with the Pensions Act 2011 (Consequential and Supplementary Provisions) Regulations 2014 sets out transitional, consequential and supplementary arrangements, including actions which must be taken by trustees and managers of occupational pension schemes, once the clarified definition of money purchase benefits in section 29 of the Pensions Act 2011[1] takes effect. It makes a range of provisions for benefits that were treated as money purchase, but that do not meet the clarified definition, to allow those schemes to comply with existing pension protection measures. In most cases schemes will not need to revisit past decisions but the Regulations will ensure that in the future members' benefits are protected.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 This instrument includes measures modifying the application of both primary and secondary legislation for transitional purposes in cases where benefits or schemes are affected by the commencement of section 29 of the Pensions Act 2011.

3.2 The enabling powers for this instrument include sections 30(1) and (2), 31(1) and 33(1)(a), (b) and (d) of the Pensions Act 2011. Under section 33(4) of the Pensions Act 2011, a statutory instrument containing regulations under Part 4 of that Act that do not amend an Act is subject to the negative Parliamentary procedure.

3.3 All the regulations in this instrument attract the negative resolution procedure. Related provisions subject to the affirmative resolution procedure are contained in the Pensions Act 2011 (Consequential and Supplementary Provisions) Regulations 2014. The two instruments implement section 29 of the Pensions Act 2011.

3.4 The provisions in this instrument and those in the Pensions Act 2011 (Consequential and Supplementary Provisions) Regulations 2014 were originally contained in one instrument laid on 6 May 2014 in draft for approval of both Houses of Parliament under the affirmative resolution procedure.

3.5 That instrument was withdrawn and replaced by this instrument, which contains only those provisions subject to the negative Parliamentary procedure, and by the Pensions Act 2011 (Consequential and Supplementary Provisions) Regulations 2014, containing only provisions subject to the affirmative Parliamentary procedure. Accordingly the procedure for free issue of the two separate instruments has been applied.

3.6 The Department's decision to withdraw the original instrument and to replace it with two separate instruments was prompted by the Committee's request for a memorandum from the Department concerning the appropriate Parliamentary

[1] http://www.legislation.gov.uk/ukpga/2011/19/part/4/enacted

procedure for the original instrument that had been subject to the more stringent procedure.

4. Legislative Context

4.1 The definition of money purchase benefits is fundamental to pensions law. The law treats money purchase benefits differently from other benefits, such as those offered by final salary schemes. A range of statutory provisions protect members with benefits that are not money purchase against the risk that their scheme is not able to meet the pensions promise. These provisions do not apply to money purchase benefits.

4.2 The Supreme Court judgment in Bridge Trustees v Houldsworth and another (2011)[2] decided that certain benefits could be considered money purchase benefits even though it was possible for them to have a shortfall in their funding. This created uncertainty about the type of benefit structures that fall within the definition of money purchase benefits.

4.3 Section 29 of the Pensions Act 2011 clarifies the definition of money purchase benefits by limiting it to those benefits that cannot have a funding shortfall.

4.4 Section 29 will take effect back to 1 January 1997 to ensure that decisions made by trustees acting in accordance with the clarified definition, rather than with the Supreme Court decision, are not called into question. This instrument provides supporting measures that allow schemes to come into compliance with legislative requirements for benefits that are not money purchase.

4.5 Decisions taken by schemes between 1 January 1997 and the coming into force of section 29 will in most cases be validated. In almost all areas, the practical effect of section 29 upon schemes which took decisions incompatible with the clarified definition will only be prospective.

4.6 These provisions will not apply to the Imperial Home Décor Pension Scheme (the scheme considered by the Supreme Court) because it is an established principle that a successful litigant should receive the benefit of a decision made in their favour.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain. Part 15 on the Financial Assistance Scheme also extends to Northern Ireland. The Department for Social Development in Northern Ireland will be producing its own legislation replicating these Regulations for Northern Ireland, apart from the provisions on the Financial Assistance Scheme.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- **What is being done and why**

7.1 Occupational pension schemes offer benefits that are either money purchase benefits or non-money purchase benefits. The Government's view is that the term

[2] [2011] UKSC 42

‘money purchase benefits’ should only refer to those pension rights which are wholly backed by matched assets and cannot develop surpluses or deficits. These Regulations set out how existing regulatory requirements will apply to benefits that have been treated as money purchase but do not meet the clarified definition of money purchase benefits.

7.2 Part 8 of these regulations in relation to the revaluation of benefits and Part 13 in relation to decisions by the Board of the Pension Protection Fund, should be read in conjunction with the Pensions Act 2011 (Consequential and Supplementary Provisions) Regulations 2014 which also form part of the implementation of section 29. Those regulations amend primary legislation for transitional and consequential purposes with prospective effect.

7.3 The majority of schemes affected will be those offering a mixture of money purchase and non-money purchase benefits.

7.4 This instrument provides transitional protection so that where benefits have been treated as money purchase prior to the coming into force date they remain so, as it would not be practical to reverse these decisions. For example, where a scheme has entered the Pension Protection Fund based on a valuation that did not include benefits treated as money purchase benefits, this decision will stand.

7.5 From the coming into force date, schemes including benefits that are not money purchase must comply with regulatory requirements for non-money purchase schemes within the periods specified. For example, pension protection levy bills will not include affected benefits until the first full levy year after the commencement of section 29, which is 2015/16.

7.6 Specific regulatory requirements under each part of this instrument are explained below.

The definitions of cash balance, money purchase underpin and top-up benefits

7.7 These Regulations describe the features of certain types of benefits, in particular:

- cash balance benefits - where a pot of money (which may be a notional pot) is built up through contributions, but there is some form of promise in relation to the amount accumulated. No promise is made in relation to the level of pension to be provided;
- underpin benefits - an arrangement where the member has a right to the greater or greatest of two or more types of benefit under the scheme; for example, the greater of a money purchase pot or a final salary pension;
- top-up benefits - an arrangement calculated by the difference between the amount of a money purchase benefit and a pre-set level or value.

7.8 These Regulations make it clear that the existence of a contingent promise to a non-money purchase benefit either as an underpin or top-up benefit under a scheme does not affect the categorisation of money purchase benefits. This is provided that the money purchase benefit, at the time the benefits are being valued, is of greater value than that of the underpin benefit or pre-set level in a top-up benefit.

Protected rights

7.9 Until 6 April 2012, contracting out of the State Second Pension was allowed on a money purchase basis. Scheme members who were contracted out received rebates on their national insurance contributions at the standard rate. This rebate, and in some cases, other contributions, were invested as a protected right money purchase benefit to provide a money purchase pension as an alternative to the State Second Pension.

7.10 These Regulations validate the treatment of cash balance benefits, the defined benefit minimum in an underpin benefit, and top-up benefits as money purchase benefits for the purposes of the protected rights legislation. This will apply both before and after this form of contracting out was abolished in April 2012 in order that these benefits meet the legislative requirements for protected rights.

Modification of schemes

7.11 The rules of some occupational pension schemes include a power of amendment which allows accrued rights to benefits to be modified. These Regulations validate the exercise of such a power to convert benefits treated as money purchase to money purchase benefits prior to the coming into force date, provided that the actuarial value of the benefit was maintained.

7.12 They also protect members by preventing detrimental modifications to a contingent promise to provide an underpin benefit or top-up benefit. The nature of these benefits is that members' entitlement to money purchase or non-money purchase benefits will not be clear until the point at which they are paid.

Winding up

7.13 These Regulations protect schemes treated as money purchase schemes and those schemes that offered both money purchase and non-money purchase benefits, where winding up has begun before the coming into force date, whether or not it is completed by this date.

7.14 Where trustees treated schemes providing cash balance benefits or pensions derived from money purchase benefits as money purchase schemes, decisions not to apply the legislative priority order for discharging benefits in an underfunded scheme will be validated. Only schemes providing these benefits, money purchase benefits or benefits payable on the death of a member are covered, as the current definition of money purchase scheme could not encompass a scheme which might provide a non-money purchase benefit.

7.15 Where a scheme is being assessed for entry to the Pension Protection Fund before the coming into force date but subsequently does not enter the Fund, the trustees may continue to treat the specified benefits as money purchase for the purposes of winding up the scheme under the priority order.

7.16 These Regulations extend the trustees' powers to discharge as money purchase benefits pensions which come into payment before 1 April 2015 and which are derived from additional voluntary contributions. This will ensure that members are treated in the same way, whether the scheme enters the Pension Protection Fund or winds up outside it.

Deficiencies in the assets

7.17 Where an employer ceases to participate in an occupational pension with non-money purchase benefits, that employer is, unless other arrangements are made, required to make good any shortfall between the assets and the liabilities of the scheme. These Regulations ensure that in most cases the trustees and managers of schemes will not have to revisit past decisions or debt calculations.

7.18 Further provision is made for schemes that provided non-money purchase benefits which were treated as money purchase, but which were not affected by the Bridge judgment or by section 29. Provided that the scheme is not in winding up, and is either fully funded or has in place a recovery plan within 18 months of the coming into force date, the trustees or managers will not have to calculate any debt on an employer in relation to the scheme.

Revaluation, indexation and preservation of benefits

7.19 These Regulations allow cash balance benefits accrued before the coming into force date to be revalued using a modified money purchase method which includes notional returns as well as actual investment returns. Both these Regulations and the Pensions Act 2011 (Consequential and Supplementary Provisions) Regulations 2014 need to be read together in such cases. Those regulations amend primary legislation to introduce a method of revaluation for cash balance benefits, which, going forward, allows deferred members' benefits to be revalued in any way in which they would have been if the member had remained in the same pensionable service.

7.20 These Regulations also prevent schemes from having to unpick existing pensions in payment where the pension has been calculated without inclusion of the statutory limited price indexation required for non-money purchase benefits.

7.21 The pensions of scheme members who leave before the normal pension age of their scheme are preserved. These Regulations amend existing provisions to remove the uniform accrual requirements in relation to money purchase benefits.

Transfers

7.22 These Regulations provide that, from the coming into force date, the cash equivalent value of cash balance benefits will be calculated in a similar way to transfer values for money purchase benefits, but, if the scheme is underfunded, the transfer value may be proportionately reduced.

Early leavers: Cash Transfer Sums and Contribution Refunds

7.23 The cash transfer sum available to those who leave certain types of pension scheme after less than two years is calculated in a similar manner to the transfer values of preserved pensions. Schemes will not have to recalculate cash transfer sums where the transfer has already taken place before the coming into force date. From that date, cash transfer sums relating to cash balance benefits will be calculated in a similar way to money purchase benefits but, if the scheme is underfunded, the transfer value may be reduced proportionately.

Payment of surplus funds to employer

7.24 Existing legislation requires that before payments of surplus funds from an occupational pension scheme that is not a money purchase scheme are made to an employer certain conditions, including arranging an actuarial valuation, must be met. Payment of surplus funds from a money purchase scheme (resulting, for example, from deceased members' benefits) may be made to an employer without meeting the conditions: because members' benefits are ring-fenced, there is no risk of underfunding.

7.25 The Regulations provide that schemes do not have to revisit such decisions made up to the commencement date. Where a scheme wishes to make a surplus payment after the coming into force date it is required to use a valuation which reflects the clarified definition.

Scheme Administration

7.26 Occupational pension schemes that are non-money purchase are required to appoint an actuary. Schemes that have not appointed an actuary are exempted from this requirement in relation to past periods, but must do so on or before 6 October 2014. An actuary is not required to be appointed in relation to a period during which the scheme is exempted from that requirement by the Scheme Administration Regulations.

7.27 Trustees or managers will not have to revisit scheme accounts produced before the coming into force date.

The Pension Protection Fund

7.28 The Pension Protection Fund protects members of non-money purchase occupational pension schemes if the sponsoring employer of their scheme has become insolvent on or after 6 April 2005. A scheme that is newly protected by the Pension Protection Fund will need to submit the first valuation for levy purposes by 31 March 2015. Pension protection and administration levies will be due in the 2015/16 financial year. Schemes already eligible will not need to revisit levy payments for any financial year prior to 2015/16. This will allow time for the trustees and managers of schemes to comply with requirements for valuations used to calculate the levy. These Regulations give the Board of the Pension Protection Fund the power to request that affected schemes provide an out of cycle valuation.

7.29 Valuations or funding determinations used by the Board to determine whether it should assume responsibility for a scheme will remain valid for any date prior to the coming into force date. Where the Board has discharged certain benefits that do not meet the clarified definition of money purchase benefits before the coming into force date, such actions will not need to be revisited. This recognises that it would not be practical for schemes to unpick such decisions nor fair to their members.

7.30 Some members receive a pension from additional voluntary contributions made alongside contributions to a defined benefit pension. Where such a pension (resulting from money purchase benefits or from other affected benefits) comes into payment before 1 April 2015 it will be treated as money purchase if the schemes enters an assessment period at any time after the coming into force date. This recognises that scheme members may have chosen to convert their additional voluntary contributions to a scheme pension on the understanding that the pension would be discharged as money purchase benefits if the scheme entered the Pension Protection Fund.

7.31 The Pension Protection Fund Entry Rules are amended so that where a compromise agreement has been made prior to the coming into force date, the scheme will not be excluded from eligibility for the Pension Protection Fund for this reason. The amendment also provides for a newly eligible scheme to be treated in the same manner as a newly established scheme in terms of the period of time it must be eligible before it may transfer to the Pension Protection Fund.

7.32 Pension compensation paid by the Board of the Pension Protection Fund is mainly based on the scheme's promise of income stream in retirement. Where the scheme has offered a guarantee on a lump sum to the member there is no income stream. These Regulations extend existing provisions to include schemes that promise a lump sum so that the Pension Protection Fund can convert this into an income. Actuarial factors will be applied to the lump sum to turn it into an income that will then be regarded as the protected pension rate, to which compensation arrangements can be applied. Where a member's pension is not being indexed, it will remain unindexed once the member receives pension compensation.

7.33 Decisions made by the Board of the Pension Protection Fund relating to the discharge of benefits previously considered to be money purchase will be reviewable under the existing review process. These decisions are to be included in the list of reviewable matters set out in primary legislation, in amendments made by the Pensions Act 2011 (Consequential and Supplementary Provisions) Regulations 2014).

Scheme Funding

7.34 These Regulations allow any scheme treated as a money purchase scheme to be treated as a newly created scheme for the purposes of scheme funding valuations. This means the effective date at which the assets and liabilities are valued must be within 12 months of the coming into force date and that the valuation must be completed within 15 months of the effective date.

7.35 Where schemes have previously carried out valuations but have not included benefits that they had considered money purchase, these benefits will need to be included in the next scheme valuation, if they do not meet the clarified definition of money purchase benefits. Any valuation completed prior to the coming into force date will continue to be valid. If the trustees or scheme managers of a scheme consider it appropriate, these Regulations give them the flexibility to carry out a valuation earlier than is normally required.

Schedules of Payments

7.36 Occupational pension schemes are required to have in place a process to collect and record the contributions which fund the scheme. For money purchase schemes this is represented by a schedule of payments and for non-money purchase schemes, a schedule of contributions is required.

7.37 Schemes that become subject to scheme funding requirements for the first time will not have to prepare a schedule of contributions immediately, as the existing schedule of payments will remain in force until the first schedule of contributions is certified. Schemes will have up to 27 months from the coming into force date to comply with existing scheme funding requirements.

Financial Assistance Scheme

7.38 The Financial Assistance Scheme provides assistance for non-money purchase occupational pension schemes which began winding up underfunded in a past period. These Regulations provide that if a scheme was treated as a money purchase scheme immediately before it began to wind up, it will remain so. Where the clarified definition would have the effect of changing a scheme's status from money purchase to non-money purchase, these Regulations prevent the scheme from qualifying for the Financial Assistance Scheme as a scheme which is non-money purchase. These Regulations also validate any action taken to discharge benefits previously considered to be money purchase benefits in a scheme that enters the Financial Assistance Scheme.

Equality

7.39 These Regulations give certainty that schemes which apply different actuarial factors for men and women when converting money purchase benefits to a rate of scheme pension will continue to be able to do so.

Pension Sharing on Divorce

7.40 Where the pension sharing process had begun before the coming into force date, any valuation already undertaken to enable the couple to come to a financial settlement will not be affected. In addition, any further valuation of the same rights as part of the pension sharing process may be made on the same basis as the first. This will avoid schemes having to undertake revised valuations because the cash equivalent value of money purchase benefits is calculated differently to that of non-money purchase benefits.

Cross-border Schemes

7.41 Occupational pension schemes which are based in the UK are able to receive contributions from European employers. The requirements for authorisation to receive contributions are different for money purchase schemes and non-money purchase schemes.

7.42 Any affected schemes will have up to a year from the coming into force date to apply to the Pensions Regulator for authorisation on a non-money purchase basis. The existing money purchase authorisation will remain valid until the Pensions Regulator either grants or refuses the fresh application.

Disclosure

7.43 The content of information trustees or managers of an occupational pension scheme are required to give to members can be different depending on whether benefits are money purchase or not. Schemes will not have to go back and change the information they have provided before the commencement date. These Regulations also amend existing requirements to set out what information should be provided in relation to cash balance benefits.

- **Consolidation**

7.44 Informal consolidated text of instruments is available to the public free of charge via 'The Law Relating to Social Security' (Blue Volumes) on the Department for Work and Pensions website at http://www.dwp.gov.uk/publications/specialist-guides/law-volumes/the-law-relating-to-social-security/ or the National Archive website legislation.gov.uk . An explanation as to which instruments are maintained on each site is available here."

8. Consultation outcome

8.1 The Department held a public consultation on a set of draft Regulations that included both the provisions in this instrument and those in the Pensions Act 2011 (Consequential and Supplementary Provisions) Regulations 2014, between 31 October 2013 and 12 December 2013. There were 95 written responses from pensions industry representatives, trustees and employers. During the consultation period the Department held four stakeholder forums that were attended by over 100 people in total.

8.2 The majority of stakeholders (68 of the written responses) were of the view that where schemes had not acted consistently with the Department's understanding of money purchase benefits, they could incur some costs if required to revisit decisions made after 27 July 2011. This was the date of the Department's statement of intention to clarify the definition of money purchase benefits. These Regulations take account of this and now validate actions and decisions taken after 27 July 2011 and the coming into force date in all areas. All other responses were silent on the issue.

8.3 The other significant area of comment concerned the nature of benefits that schemes may have considered money purchase but that do not meet the clarified definition. These Regulations now include provision relating to underpin and top-up benefits to remove the need to correct past actions.

8.4 The Government response can be found at: https://www.gov.uk/government/consultations/definition-of-money-purchase-benefits-in-occupational-pension-schemes

9. Guidance

9.1 The Pension Protection Fund guidance about valuations will be updated to reflect these changes.

10. Impact

10.1 These Regulations are of net but unquantified benefit to business and civil society organisations.

10.2 The impact on the public sector is minimal and arises from the need to ensure that members of occupational pension schemes are included in pension protection measures in respect of non-money purchase benefits. This complies with the European directives to protect member benefits and ensure that members receive a meaningful income in retirement.

10.3 An impact assessment is attached and will be published alongside this Explanatory Memorandum on www.legislation.gov.uk.

11. Regulating small business

11.1 Pensions legislation exempts, for most purposes, schemes with less than 12 members and there are very few small businesses which provide an occupational pension scheme. Therefore any impact would be negligible.

11.2 As these regulations are deregulatory, neither sunsetting provisions nor the Small and Micro-Business Assessment are applicable.

12. Monitoring & review

12.1 There is no planned evaluation of this Statutory Instrument. It will be monitored through ongoing stakeholder engagement with the pensions industry.

13. Contact

13.1 Alison Humberstone OBE at the Department for Work and Pensions Tel: 0207 449 5132 or email Alison.humberstone1@dwp.gsi.gov.uk can answer any queries regarding the instrument.