Pension Protection Fund

Consultation Document

Money Purchase Benefits

May 2014

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1. Introduction and summary

1.1 The definition of “money purchase benefits” was amended by the Pensions Act 2011 and will come into force later this year. At the same time the Pensions Act 2011 (Transitional and Consequential Provisions) Regulations 2014 will come into force. As well as providing transitional protection that will prevent trustees having to revisit certain past decisions, these regulations give the Board of the PPF an explicit power to instruct trustees to commission one-off valuations to include benefits that were formerly money purchase. Such valuations are referred to in the regulations as **out of cycle** valuations.

1.2 In this consultation we set out our proposed policy on **out of cycle** valuations and how we propose to value the new benefits that fall under our remit.

1.3 We refer to schemes that have not previously been covered for PPF protection as **Newly Eligible Schemes**. Under the regulations, such schemes must submit their first s179 valuation by 31 March 2015 and will become eligible for PPF protection from 1 April 2015.

1.4 We refer to schemes that are already eligible for the PPF but which will see a new element of their benefit structure fall under our protection as **Increased Liability Schemes**. Our discretion to call for **out of cycle** valuations relates to these schemes.

1.5 We propose to exercise our discretion to call for **out of cycle** s179 valuations in cases where the s179 valuation on the Regulator’s Exchange system at 5pm on 31 March 2015 would not otherwise take account of the new definition of money purchase benefits.

1.6 However, we will only call for **out of cycle** valuations where the impact is **material**. We propose to define **material** as meaning that the change in the definition of money purchase causes a change in the latest s179 valuation’s surplus or deficit that is more than 10% in relative terms and is more than £5m in absolute terms.

1.7 We will update our valuation guidance for s143, s152, s156 and s179 valuations to set out how benefits that are no longer money purchase should be valued.

1.8 Sections 2 and 3 of this document expand upon our policy for out of cycle valuation, and section 4 summarises the changes we will make to our valuation guidance. Section 5 sets out the particular questions we wish to put to stakeholders and section 6 explains how to respond to this consultation. In section 7 we have summarised the key terms used in this document. Words or phrases in bold type in this document are defined in this section.

1.9 This consultation closes on 9 July 2014 and we look forward to hearing respondents’ views.

2. Out of cycle s179 valuations

2.1 One option is for us to instruct all **Increased Liability Schemes** to provide an **out of cycle** valuation where the s179 valuation on the Regulator's Exchange system would not otherwise take account of the new definition of money purchase benefits. This would ensure that schemes paid a levy that fairly reflected the level of risk that their benefit structure poses and would reduce the amount of cross-subsidy between levy payers.

2.2 However, we consider it would be inappropriate to ask all schemes to produce a valuation as in most cases the cost of producing such a valuation would be disproportionate compared with the impact on the levy paid. It would thus have a detrimental effect on the scheme itself, on the PPF and on other levy payers.

2.3 At the other extreme we could, while being careful not to fetter our discretion, decide not to call for any **out of cycle** valuations as a matter of course. This would be on the grounds that deficits from the new benefits may turn out to be relatively small and will be reflected in our data in the coming years when schemes submit their next s179 valuation.

2.4 On balance we have decided that it is appropriate to ask for **out of cycle** valuations from schemes, but only where that impact is **material** and only where the s179 valuation on Exchange on 31 March 2015 would otherwise not take account of the new definition of money purchase benefits. Our proposed policy is therefore:

*Where the s179 valuation that the trustees would otherwise submit on Exchange at 5pm on 31st March 2015 does not take account of the amended definition of money purchase, and if the amended definition has a **material** effect, we will require an **out of cycle** valuation to be produced. Where there is uncertainty about whether the effect of the amended definition is material, an **out of cycle** valuation may be produced without actually ascertaining materiality.*

2.5 Note that the above definition makes no reference to the **appointed day**. Therefore schemes that are currently carrying out a valuation with an effective date before the **appointed day** may adopt the new definition of money purchase and if they do so will not be required to produce an **out of cycle** valuation, provided their s179 valuation is submitted on Exchange before 5pm on 31 March 2015.

2.6 We envisage that there will be some schemes that wish to carry out a special valuation with an effective date before the appointed day, for example to make use of already existing relevant accounts, rather than go to the expense of conducting an **out of cycle** valuation at an inconvenient date.

2.7 We expect that our proposed policy will lead to a relatively small number of **out of cycle** valuations being submitted by schemes, and only then for schemes where the cost of providing the valuation is small relative to the additional risk posed to the PPF. However, we have relatively limited anecdotal evidence on the extent to which schemes will be affected, and would particularly wish to hear from consultants what they expect the likely impact will be.

How out of cycle valuations would be commissioned and carried out

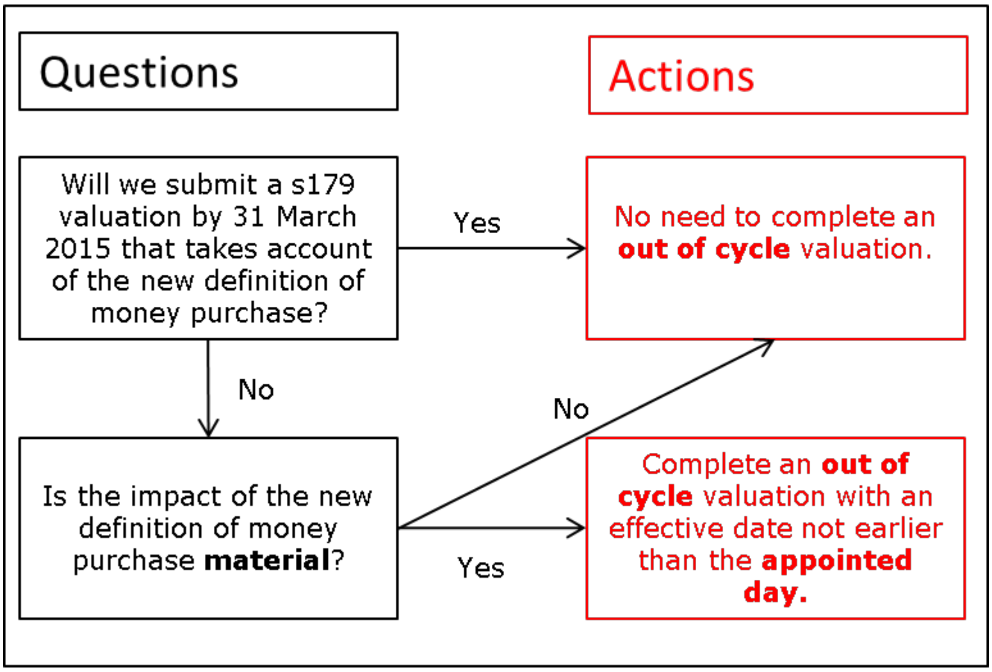
2.8 We would write to all schemes currently eligible for PPF protection to explain our new policy. We would then expect trustees to determine whether they had any formerly money purchase benefits and, if so, and if they were not otherwise expecting to submit by 31 March 2015 an s179 valuation using the new definition of money purchase benefits, to direct their scheme actuaries to gauge the impact of the amended definition.

2.9 We would expect that in some cases the actuary could conclude that the impact is not material without incurring much cost. For example, inspection of high level data such as that shown in the scheme accounts, or a summary taken from the administration system, may be sufficient to conclude that the benefits will not fall under our definition of materiality, as given in the next section.

2.10 If the effect were not **material,** no further action would be necessary. In particular we would not require schemes to contact us.

2.11 If the effect were **material**, then the trustees should commission an **out of cycle** s179 valuation and submit it on Exchange by 31 March 2015. The regulations require an **out of cycle** s179 valuation to have an effective date between the **appointed day** and 31 March 2015.

2.12 The following flow diagram illustrates the decision-making process that trustees should go through.



3. Materiality test

3.1 The ultimate determinant of materiality is the impact the new definition of money purchase benefits has on a scheme's PPF levy and, were this readily calculable, we would have this as our materiality test. However, we consider it would be unreasonably costly to expect actuaries to carry out this complex calculation.

3.2 Given that the PPF Levy is for the most part risk-based and depends upon the underfunding risk posed by schemes, we have decided to express our materiality test in terms of the underfunding risk posed to the PPF. Although for levy purposes we use a smoothed and stressed definition, in its simplest form the underfunding risk is the deficit (or surplus) in the scheme.

3.3 We propose therefore to use the following definition of "**material**":

The effect of the new definition of money purchase benefits is ***material*** *where the s179 surplus or deficit changes by at least 10% in relative terms and by at least £5m in absolute terms when taking account of benefits that cease to be money purchase.*

3.4 For example, if the s179 deficit increases from £100m to more than £110m this would be material as the change exceeds 10% and £5m. Similarly, if the surplus decreased from £100m to £90m or less this would be material.

3.5 Under our definition, materiality will depend on market conditions and therefore vary over time. We considered using a common date so that all schemes were on the same footing for the test. However, this would be a relatively complicated and expensive calculation to carry out. Therefore, the test should be made at the effective date of the latest s179 valuation that has been submitted, or will be submitted, on the Regulator's Exchange system at 5pm on 31 March 2015.

3.6 We intend that this definition applies to all **Increased Liability Schemes**, including schemes in surplus and schemes where the risk-based levy is capped.

Schemes in surplus

3.7 Our levy data shows that there are often significant differences between the s179 position and the position after smoothing and stressing has been carried out for levy purposes. This results in many schemes that are in surplus at the s179 date being required to pay a risk-based levy. A change in the surplus at the s179 date would therefore change the scheme's risk-based levy unless the scheme is so well funded that it is still in surplus even after smoothing and stressing.

3.8 On the basis that a lot of schemes in surplus do not fall in this category and also for simplicity and consistency, we believe it best for these schemes to be treated in the same way as other schemes.

Schemes with a capped risk-based levy

3.9 These schemes may only see a small change in their risk-based levy after providing an **out of cycle** s179 valuation. However, these schemes are already being subsidised by the levies paid by other schemes and so it would not seem fair to treat them any more favourably by not requiring them to consider the effect of the new money purchase rules.

3.10 For the above reason, the fact that only a small proportion of schemes are of this nature, and on the grounds of simplicity and consistency, we believe it is best for these schemes to be treated in the same way as other schemes.

4. Updates to PPF valuation guidance

4.1 In this section we set out some of the changes that we will be making. We propose that the updated PPF valuation guidance including the requirements for **out of cycle** s179 valuations will be effective from the **appointed day**.

4.2 The regulations do not specify how to value some of the benefits that become eligible for PPF protection following the amended definition of money purchase benefits coming into force. We therefore propose to make the following updates to our Valuation Guidance to clarify how such benefits should be valued.

Internally annuitised pensions

4.3 For schemes that internally annuitise pensions, we propose the following treatment for s179 valuations:

4.4 Benefits that haven't yet been internally annuitised at the **Relevant Time** should be regarded as money purchase and excluded from both the assets and liabilities of the valuation.

4.5 For benefits that have been internally annuitised at the **Relevant Time**, the pensions should be valued in the same way that benefits already protected by the PPF before the amended definition of money purchase benefits comes into force would be. For example, benefits will have pension increases of CPI inflation capped at 2.5% p.a. for post 1997 accrual, application of a 90% factor and the PPF Compensation Cap if the member is under Normal Pension Age at the **Relevant Time**. Pre / post 1997 accrual can be determined either using total contributions paid (member and employer) or the member's service period.

4.6 For s143 valuations, the regulations provide transitional protection in certain circumstances for AVCs that were annuitised internally before 1 April 2015. We will be updating our guidance to reflect this. **AVC** benefits that are internally annuitised after 1 April 2015 should be treated as in paragraphs 4.4 and 4.5 above.

Guaranteed investment returns

4.7 For benefits with a guaranteed investment return, the higher of the value of the benefits with and without the guaranteed investment return applied up until the **Relevant Time** should be valued in the same way as benefits for cash balance schemes as set out in our valuation guidance. The guaranteed investment return should not be applied to the period after the **Relevant Time**.

5. Questions

5.1 The Board would be grateful to receive responses to the following questions:

Q1. Do you consider it is reasonable for the PPF to exercise its discretion to require **out of cycle** s179 valuations in circumstances where it judges the effect to be material?

Q2. Do you consider the materiality test to be reasonable? If not, what would you propose as an alternative?

Q3. Do you have any information on the approximate number and size of schemes that would be required to provide an **out of cycle** s179 valuation if the proposed materiality test is applied? If so then we would be very interested to hear about any information that you can provide.

Q4. Do you consider the proposed updates to the **PPF Valuation Guidance** to be reasonable? If not, what would you propose as an alternative?

Q5. Are there any benefits you are aware of that need to be included in the updated **PPF Valuation Guidance** that aren't included in the current guidance or in the proposed updates (i.e. internally annuitised pensions, money purchase underpins/top-ups and guaranteed investment returns)?

5.2 The Board would also be interested to receive your comments on any other matter in this consultation document which is not included in responses to the questions above.

6. Responding to the consultation

6.1 The consultation period begins 28 May 2014 and will end on 9 July 2014. Please ensure that your response reaches us by that date. If you would like further copies of this document it can be found at the Valuation Guidance section of the Pension Protection Fund website at www.pensionprotectionfund.org.uk.

6.2 Please e-mail responses to:

amendedmpdefinition@ppf.gsi.gov.uk[1]

6.3 Please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

6.4 In the event of any queries, please contact:

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6.5 The requirements of the Freedom of Information Act (2000) state that all information contained in the response, including personal information, may be subject to publication or disclosure. By providing personal information for the purpose of the public consultation exercise, it is understood that a respondent consents to its disclosure and publication. If this is not the case, the respondent should limit any personal information which is provided, or remove it completely. If a respondent requests that the information given in response to the consultation be kept confidential, this will only be possible if it is consistent with the Freedom of Information Act (2000) obligations and general law on this issue. Further information about the Freedom of Information Act (2000) can be found on the website of the Ministry of Justice.

6.6 The Board will publish a summary of responses on the PPF website at www.pensionprotectionfund.org.uk by 16 July 2014. At the same time it will also publish its updated PPF valuation guidance including requirements for **out of cycle** s179 valuations.

[1] Amended on 30 May 2014 (previously amendedmoneypurchasedefinition@ppf.gsi.gov.uk).

6.7 The Board would value any feedback on the effectiveness of this consultation process. If you have any comments then please contact:

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7. Definition of terms

Appointed day – the day on which the amended definition of money purchase benefits in section 29 of the Pensions Act 2011 comes into force. This is expected to be in July 2014.

Increased Liability Schemes – schemes that have always been eligible for PPF protection and whose protected liabilities will increase because they have benefits that will no longer be money purchase under the new definition.

Material – where the change to the definition of money purchase benefits changes a scheme's surplus or deficit by at least 10% in relative terms and at least £5m in absolute terms, this is deemed a material impact.

Newly Eligible Schemes – schemes that are currently money purchase but provide some benefits that will cease to be money purchase when the amended definition comes into force. The scheme will therefore be newly eligible for PPF protection when the amended definition of money purchase benefits comes into force.

Out of cycle s179 valuation – a valuation that has been requested by the Board of the PPF under the Pensions Act 2011 (Transitional and Consequential Provisions) Regulations 2014.

Relevant Time – this is the formal name for the effective date of the valuation. The definition varies for s143, s179, s152, s156 and s158 valuations.