

## PREMIER PENSIONS MANAGEMENT

### LEGISLATION UPDATE : 03/06

#### **How does the PPF protect pension derived from an AVC fund?**

The Pension Protection Fund (PPF) was established to provide protection to Defined Benefit Schemes. On an insolvency event the amount of benefit a member of a Defined Benefit Scheme can expect will depend on their age at the time of the insolvency.

- For members aged 65 or over they receive their full entitlement
- For members under age 65 they receive 90% of their full entitlement subject to a cap on the maximum pension available of £25,000 pa at age 65.

Members in this latter category are therefore subject to a possible reduction in benefits if their Scheme enters into the PPF.

Defined Contribution Schemes generally fall outside of the remit of the PPF and as such the restrictions on a members pension after an insolvency event do not apply.

An interesting question then for Trustees of a Defined Benefit Scheme is “what happens to a members AVC fund?”

#### **As you would expect the answer is not straight forward.**

Suppose we have member A, who is 63 and has accrued a £30,000 pa pension in a Defined Benefit Scheme. On top of this he has a £40,000 AVC fund. If the Scheme goes into the PPF what happens to his AVC fund, is it fully protected, so in effect he receives a pension from the PPF in excess of the Cap, or is the AVC fund “lost” as his pension is already in excess of the PPF maximum?

The legislation provides that “money purchase benefits” can effectively be treated separately to other Scheme benefits and be paid independently during the assessment period – when the Scheme is assumed by the PPF, the PPF compensation is not offset by the amount of such money purchase benefits paid out during the period. i.e. compensation is not affected by the members money purchase benefits. Therefore, do AVC’s fall within the definition of “money purchase benefits”

Money purchase benefits are defined as “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.

#### **Therefore, logically:**

- Any AVC that is paid to secure money purchase benefits “outside” the Scheme (e.g. in a separate AVC policy) should fall into this definition and so outside the compensation provisions and not potentially scaled back.

## However

- Where AVCs are paid to secure added years benefits in a Scheme, (even if in a separate policy) it is possible that these benefits might not fall within the definition of “money purchase benefits” because they can be said to be determined by reference to a benefit promise of added years conditional on the payment of additional contributions, rather than being determined by the contributions themselves. Therefore, these benefits could be scaled back under the compensation provisions.
- There could be a scenario where a member paying AVCs has the choice at retirement of securing additional benefits through the Scheme by way of added years or purchase a pension in the market. These would seem to satisfy the definition of “money purchase benefits” because (in the former) the additional years would be determined by reference to the contributions made by the member. This is a subtle difference to the point above.

## Just when you thought you were getting some clarity on the point:

- We understand that there is some debate about whether benefits in respect of money purchase AVCs that are being paid from the Scheme fall within the definition of “money purchase benefits”.

The PPF has expressed a view (on its web-site) that such money purchase AVCs would appear to remain money purchase even after they have come into payment and are being paid by the Scheme. The PPF has noted that a recent case (where leave to appeal has been sought) has shed doubt on this view. The PPF has suggested that until the outcome of the case is determined the position is subject to uncertainty (leave to appeal has now been refused and so the situation remains ambiguous). We understand the PPF is considering taking Counsel’s opinion on the issue, however until this happens the position remains uncertain.

## So where does this leave Trustees and there communication with members?

Members should be advised of the potential issues. From A Day they will have the choice of continuing with their AVC contributions or make additional contributions outside of the Scheme.

A further PPM update will be provided as the situation develops.

**MARCH 2006**