



An tÚdarás Pinsean
The Pensions Authority

FAQs ON APPLICATION OF PRESERVATION REGIME TO DEFINED BENEFIT RESTRUCTURINGS

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The restructuring mechanisms of freezing accrual and/or adjusting the link to final salary are becoming more common for defined benefit final salary schemes. The provisions of Part III of the Pensions Act and the Authority's existing guidance on Part III concerning the preservation of benefits for early leavers do not specifically deal with how certain aspects of the preservation regime, namely **statutory revaluation** and the "**phasing in**" of benefit reductions should apply in the aforementioned restructuring scenarios.

These FAQs are intended to provide assistance to schemes on how the relevant provisions concerning statutory revaluation and phasing in should be interpreted where defined benefit schemes seek to restructure by freezing accrual and/or altering the link to final salary.

These FAQs should be read in conjunction with the Authority's existing guidance on preservation which can be accessed on our website.

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Overview

There are two key aspects of the preservation regime under the Pensions Act 1990, as amended (the “**Act**”) that are relevant to these FAQs. The first is statutory revaluation and the second concerns the concept of “phasing in” benefit reductions/improvements. At the outset, it is important to note that an entitlement to a preserved benefit only arises where certain qualifying conditions are met, including the condition that a termination of *relevant employment* otherwise than on death prior to retirement/ normal pensionable age has occurred. Therefore, statutory revaluation and phasing in will only be relevant where an entitlement to a preserved benefit arises in the first place.

Statutory Revaluation/Enhancement

Statutory revaluation¹ seeks to address the effects of price inflation on a preserved benefit whereby a member’s preserved benefit must be revalued annually by a defined percentage from the date the member leaves service until the date they retire.

Where a member has periods of *reckonable service* (i.e. service as a scheme member) in more than one scheme of the same employer, the benefit in the first scheme may also be required to be revalued or “enhanced”² when the preserved benefit comes to be calculated on the termination of *relevant employment*. Essentially, enhancement operates in the same way as statutory revaluation. The purpose of enhancement is to ensure that an employee is entitled to an aggregate preserved benefit which is no less than the aggregate benefit to which they would have been entitled if their periods of *reckonable service* in the various schemes had each related to different employments.

“Phasing In”³

Broadly speaking, under the current preservation regime, a member’s preserved benefit must be calculated taking into account any benefit reduction (or improvement) that occurred while the member was in service. When calculating the preserved benefit, the reduction/improvement is accrued (“phased in”) over scheme service arising after the date of the change and only fully crystallises when a member comes to retire. In other words, it is phased in over the future working life of a member⁴. Therefore, unless a member remains in service until retirement, their preserved benefit will not reflect the full impact of the reduction/increase.

¹Section 33 of the Act.

² Occupational Pension Schemes (Preservation of Benefits) (Special Calculations) Regulations 2002 (S.I. 277 of 2002).

³ Phasing in applies to the calculation of a preserved benefit “where the basis of calculating long service benefit is altered” between the date of commencement of the member’s *relevant employment* and the date of termination of the member’s *relevant employment*. (Paragraph 2(2) of Part A of the Second Schedule of the Act).

⁴ Other than where the reduction or improvement involves a change to normal pensionable age in which case there is a 10 year cap. (Article 8 of Occupational Pension Schemes (Preservation of Benefits) Regulations 2002 (S.I. 279 of 2002)).

The phasing in effect will be applied not only when members leave service before retirement but also when determining a scheme's funding position relative to the minimum funding standard under the Act at any point in time. In this respect, changes made to defined benefit schemes with the intention of reducing the cost of benefits to tackle funding deficits (outside the confines of section 50) will not achieve an immediate cost saving benefit and the full impact of the saving will be achieved gradually over a period of time. Where benefits are reduced pursuant to section 50, the phasing in provisions of the Act do not apply in so far as they would conflict with the reduction⁵.

Relevant definitions/terms*

*While full details on the precise legislative provisions are contained in the existing guidance notes, it is useful for the purposes of these FAQs to repeat the following definitions:

“Long Service Benefit”⁶ means the benefits which will be payable under a scheme in accordance with an obligation to or in respect of a member of a scheme on the assumption that he remains in *relevant employment* until such time as he attains normal pensionable age.

“Reckonable Service”⁷ means service in the *relevant employment* during membership of the scheme but does not include service as a member of the scheme where either:

- a) the only benefit under the scheme in respect of such service is in respect of death prior to normal pensionable age; or
- b) the member has been notified in writing by the trustees that such service does not entitle them to long service benefit.

“Relevant Employment”⁸ means any employment (or any period treated as employment) to which a scheme applies.

“Phasing in”⁹ refers to the manner in which a preserved benefit is calculated where the basis of calculating long service benefit is altered between the date of commencement of the member's relevant employment and the date of termination of the member's relevant employment.

⁵ Section 50(2) of the Act

⁶ Section 2 of the Act

⁷ Section 2 of the Act

⁸ Section 2 of the Act

⁹ Paragraph 2(2) of Part A of the Second Schedule of the Act

Questions on Statutory Revaluation/Enhancement

1. Does statutory revaluation apply where a scheme freezes¹⁰ accrual of service and salary and does not provide for a replacement scheme in respect of future service?

Statutory revaluation will only be relevant where a preserved benefit arises in the first place. As a preserved benefit will only arise on foot of a termination of *relevant employment*, an assessment of whether or not the scheme still “applies” to a member’s employment must be undertaken. As no further benefits will accrue from the date of freezing and there is no replacement scheme, it would appear that the scheme ceases to apply to a member’s employment, amounting to a termination of *relevant employment*. Assuming that a termination of *relevant employment* occurs and provided that the other relevant qualifying conditions are met, a preserved benefit may be triggered, which may in turn attract statutory revaluation.

2. What is the position concerning statutory revaluation where a scheme freezes accrual of service and salary but provides access to a replacement scheme in respect of future service?

Where the accrual of benefits is halted in the manner indicated above but members are given immediate access to a replacement scheme of the same employer in respect of future service (which may be either defined benefit or defined contribution in nature), a termination of *relevant employment* will not occur as there is at all times a scheme applying to the member’s employment¹¹. Accordingly, no revaluation will be applied while the member remains in service. When a termination of *relevant employment* ultimately occurs and the preserved benefit comes to be calculated, the provisions of the Occupational Pension Schemes (Preservation of Benefits) (Special Calculations) Regulations 2002¹² will apply. When the preserved benefit crystallises, enhancement will apply from the date of the switch to the new scheme until the date of actual termination of *relevant employment*.

3. Does statutory revaluation apply where a scheme freezes accrual of service but maintains the final salary link¹³ or some growth in salary¹⁴?

Although accrual of service has ceased, keeping the link to final salary or allowing for some form of salary growth means that the pension is increasing and benefiting from the salary

¹⁰ The term “freezing” used throughout these FAQs is intended to refer to a scenario where the yearly accrual of fractional entitlements (e.g. 1/60ths) will be halted and members’ final pensionable salaries will be fixed at their existing levels.

¹¹ If a member is provided with access to a PRSA a termination of *relevant employment* will occur and statutory revaluation may be relevant.

¹² S.I.277 of 2002

¹³ By freezing accrual but maintaining the final salary link, members would cease to acquire future yearly fractional entitlements (e.g. 1/60ths) but will receive a pension (or deferred entitlement) based on their actual final pensionable salary on leaving service.

¹⁴ In some cases, schemes may not maintain the link to final salary but may allow for some form of salary growth to be pensionable e.g. a scheme may allow for CPI increases on salary to be recognised.

increases and therefore continues to apply to the member's employment. Accordingly, there is no termination of *relevant employment* and therefore a member's benefit will not be subject to statutory revaluation. The fact that the scheme continues to apply to a member's employment and that as such *relevant employment* continues indicates that a member's scheme service also continues to be "reckonable". Therefore *reckonable service* also continues, notwithstanding the cessation of accrual of service for pension purposes.

4. What is the position where a scheme freezes accrual of service but maintains the final salary link or some growth in salary and also offers a replacement scheme in respect of future service?

As noted at 3 above, keeping the link to final salary or allowing for some level of salary growth means that the scheme continues to apply to a member's employment. Therefore, *relevant employment* and *reckonable service* continue. A member will accordingly accrue *reckonable service* in both schemes simultaneously. Enhancement under the Occupational Pension Schemes (Preservation of Benefits) (Special Calculations) Regulations 2002 will operate from the date of termination of *reckonable service* to which the calculation relates to the date of termination of *relevant employment*. In this case, those dates would coincide so there would be no period in respect of which enhancement would apply. In other words the enhancement period would be zero.

Questions on "Phasing in"

5. When does an alteration in the basis of calculating long service benefit arise triggering the phasing in requirements?

As detailed on page 3, long service benefit is defined as "...the benefits which will be payable under a scheme in accordance with an obligation to or in respect of a member of a scheme on the assumption that he remains in *relevant employment* until such time as he attains normal pensionable age."

Having regard to this definition, in the Authority's view, if there is a change in the obligation under the scheme, phasing in of the relevant change under the preservation regime will be triggered. For instance, a cut in every member's basic salary (where basic salary is pensionable salary) by the employer will immediately reduce the benefits payable under a scheme. Such a reduction is not subject to phasing in as there is no change in the obligation under the scheme with respect to the manner in which benefits are calculated, i.e. benefits are still based on pensionable salary. However, a change to the definition of pensionable salary could result in the phasing in requirement being triggered.

6. Do the provisions of paragraph 2(2) of Part A of the Second Schedule concerning "phasing in" apply where a scheme freezes accrual of service and salary?

Paragraph 2(2) of Part A of the Second Schedule applies where the basis of calculating long service is altered "between ...the date of commencement of the member's *relevant*

employment and the date of termination of the member's *relevant employment*..." See question 1 above. As noted, in the case of a frozen scheme, freezing accrual of service and salary will trigger a termination of *relevant employment* and no *relevant employment* occurs following this date. There is no alteration in the basis of calculating long service benefit between the period of commencement and termination of *relevant employment*. Accordingly, paragraph 2(2) of the Second Schedule should not apply and phasing in of the preserved benefit should not arise in these circumstances.

7. Do the provisions of paragraph 2(2) of Part A of the Second Schedule concerning "phasing in" apply where a scheme maintains accrual of service but alters the link to final salary¹⁵?

In these cases, it is clear that as accrual continues, the scheme continues to apply to a member's employment and therefore there is no termination of *relevant employment* or *reckonable service*. The issue therefore is whether such a change amounts to an alteration in the basis of calculating long service benefit which must be phased in. Assuming the change is effected through a change under the rules of the scheme, the adjustment to final salary would constitute an alteration in the basis of calculating long service benefit as there has been a change in the obligation under the scheme with respect to the manner in which benefits are calculated (see question 6 above). Phasing in would therefore be triggered.

¹⁵ Many schemes are seeking to reduce deficits by continuing accrual but freezing salary or in some other way limiting salary increases (e.g. introducing career averaging, salary caps etc).