27 July 2011
[2011] UKSC 42

PRESS SUMMARY

Houldsworth and another (Respondents) v Bridge Trustees Limited and another (Respondents) and Secretary of State for Work and Pensions (Appellant)
On appeal from: [2010] EWCA Civ 179

JUSTICES: Lord Walker, Lady Hale, Lord Mance, Lord Collins, Lord Clarke.

BACKGROUND TO THE APPEAL

The subject of the appeal is an occupational pension scheme known as the Imperial Home Décor Pension Scheme ('the Scheme'), which is winding up and has a significant deficit. The appeal is concerned with the dividing line, for regulatory purposes, between defined benefit (normally earnings-related) schemes and defined contribution (or money purchase) schemes. The general nature of the distinction is that under a defined benefit scheme (the commonest variety of which is a final salary scheme), the amount of the benefit is not calculated by reference to the amount of the member's contributions. Under a money purchase scheme, by contrast, the member's and the employer's contributions, and the investment return on them, are the measure of the member's benefits.

There is a variety of techniques by which, under a money purchase scheme, the amount of the contributions by or for a member, and the investment return on them, are mathematically transposed into quantifying the pension that is the primary benefit that the member expects to receive. The Secretary of State's case is that some of the techniques (and in particular, those applicable to the voluntary investment planning ('VIP') and MoneyMatch benefits under the Scheme) take the benefits outside the definition of 'money purchase benefits' in section 181(1) of the Pension Schemes Act 1993. The essential feature of the definition is that the rate (typically so much a year) or amount (typically a lump sum) of the benefits is to be calculated *by reference to* contributions made in respect of that member. Section 73 of the Pensions Act 1995 provides a statutory order of priority in the winding up of pensions schemes but it does not apply to money purchase schemes, and it applies only in a limited way to "hybrid schemes" (under which some but not all of the benefits provided are money purchase benefits).

The appeal is of great importance to the current and deferred pensioners interested under the Scheme, since if the Secretary of State is right part of the contributions paid by or in respect of members still in service or entitled to deferred pensions at the date of commencement of the winding up of the Scheme will be used, under the statutory order of priority, to satisfy the rights of those already entitled to receipt of pensions at that date.

The three issues before the Supreme Court were: (1) Are MoneyMatch benefits money purchase benefits despite the presence of the Guaranteed Interest Fund ('GIF')? (2) If not, are they money purchase benefits to the extent that they are attributable to contributions and credits not allocated to the GIF? (3) Are pensions granted by way of internal annuities money purchase benefits?

As regards the first issue, a Scheme member's total MoneyMatch contributions were, with three possible exceptions, credited to the GIF. As the actual investment returns on contributions might be less than the guaranteed rate of return this could lead to a deficit in the fund. As regards the third

issue, in practice 'internal annuities' were used in relation to VIP and MoneyMatch benefits, so that the member's interest was converted into a pension using tables of factors periodically supplied by the Scheme actuaries and paid direct from the Scheme. This 'internal annuitisation' necessarily involves some degree of risk of the resources of the fund proving insufficient to provide all the benefits due, if investment returns are disappointing or annuitants exceed their actuarial life expectations (or both).

The proceedings were commenced in 2006 by Bridge Trustees Ltd ("the Trustee"), the independent corporate trustee of the Scheme. Three members of the Scheme were joined as representative defendants. The appellant Secretary of State was not a party to the first-instance proceedings, but was granted leave to intervene in an appeal. The appellant's case is that it is fundamental to the scheme of the legislation that money purchase schemes are always fully funded, with no risk of the assets being insufficient to meet the liabilities, and for that reason alone they are excepted from the statutory order of priority. Both the deputy judge and the Court of Appeal concluded that neither the GIF mechanism nor the provision of internal annuities (as opposed to the purchase of annuities from a life office) is incompatible with money purchase benefits.

JUDGMENT

The Supreme Court, by a 4-1 majority, dismisses the Secretary of State's appeal on the first and third issues, holding that equilibrium of assets and liabilities is not a requirement of the statutory definition of a money purchase scheme (and similarly for money purchase benefits). The second issue does not arise. Lord Walker gives the leading judgment. Lord Mance gives a separate dissenting judgment.

REASONS FOR THE JUDGMENT

On the first issue, the majority, while accepting that *KPMG* [2006] 1 WLR 97 was correctly decided on its facts, respectfully differ from the key conclusion reached by Jonathan Parker LJ in para 171 of his judgment in *KPMG*, that 'calculated by reference to' means 'calculated *only* by reference to', 'in the sense that the benefit in question must be the direct product of the contributions.' This interpretation involves reading in the word 'only', which Parliament did not use (whereas it did use 'solely' in the definition of 'flat rate benefit'). The altered phrase is then explained ('in the sense that') by reference to the contributions' 'direct product' though the statutory definition makes no express reference to investment return. Still less is there anything in the statutory definition requiring meticulous investigation as to the actual investment return earned over the years by every contribution made in respect of a member. The GIF mechanism did not unhitch a member's eventual benefits from that member's total contributions. It provided for a yield of guaranteed interest at a modest rate fixed by an objective test, together with the prospect of further bonuses at a modest rate, fixed, again, by an objective test under which the trustees had no discretion. **[70] - [73]**

On the third issue, the provision of internal annuities (as opposed to the purchase of annuities from a life office) is not incompatible with money purchase benefits. As the deputy judge put it, the distinction would produce insupportable anomalies. As the Court of Appeal put it, annuity tables based on actuarial calculations are used only at the final stage, when the member retires and the amount earned by his or her defined contributions must be converted from a lump sum into an annuity. That is inescapable under either method of provision, in that actuarial tables will be used, on the advice of actuaries, either by the trustees or by the life office (with the latter building in a profit element). **[76]**

Lord Mance is not persuaded that it is necessary or appropriate to read the 1993 Act (or subsequent legislation) as embracing within the concept of money purchase benefit, to some undefined and unclear extent, liabilities not matched with any specific asset held by the scheme. **[94]**

NOTE

This summary is provided to assist in understanding the Court's decision. It does not form part of the reasons for that decision. The full opinion of the Court is the only authoritative document. Judgments are public documents and are available at:
www.supremecourt.gov.uk/decided-cases/index.html