These notes refer to the Pension Schemes Act 2015
(c.8) which received Royal Assent on 3 March 2015

PENSION SCHEMES ACT 2015

EXPLANATORY NOTES

SUMMARY

5. The following paragraphs provide a high-level summary of the main provisions of the Act.

Shared risk schemes and collective benefits

6. The Act introduces new definitions to the legislative framework for private pensions based on the type of promise about the retirement benefit that pension schemes provide for members during accumulation. The current legislation is based on a binary structure between money purchase schemes, which traditionally offer no certainty over retirement benefit, and non-money purchase schemes, which have traditionally offered salary related pension benefits. The non-money purchase scheme category can cover a range of different pension benefit designs that offer different types of promises about the retirement benefit. However, the legislation is often perceived as offering two main options, and much existing legislation is written on the basis of a polarity between these options. The Act defines three categories of pension scheme based on the different types of promise offered to members during the accumulation phase about their pension savings when they come to access them (also termed decumulation). A defined benefits scheme is a scheme in which the member has a full pensions promise about the rate of the retirement income they will receive for life from a fixed normal pension age; a shared risk scheme is one in which there is a promise about some of the retirement benefits, whether income or lump sum; a defined contributions scheme is one where there is no promise about what is being saved.

7. The Act also includes measures to enable the provision of collective benefits. Collective benefits are provided on the basis of allowing the scheme’s assets to be used in a way that pools risks across the membership. Examples of collective arrangements which are currently in operation can be found in the Netherlands, Denmark, and parts of Canada, where evidence suggests they can, when governed appropriately, provide a greater degree of stability in pension outcomes than individual defined contributions schemes.

Pensions guidance

8. The Act sets out a framework for establishing a pensions guidance service. It provides that the Treasury must make arrangements for the provision of pensions guidance and establishes a framework for the Financial Conduct Authority (FCA) to supervise designated guidance providers delivering pensions guidance by arrangement with the Treasury. It establishes a duty on the FCA to make rules to require specified pension providers to ‘signpost’ towards the guidance service. It also provides for the funding of the pensions guidance service by way of a levy raised by the FCA on FCA regulated persons and paid to the Treasury.

Independent advice

9. The Act provides for the provision of appropriate independent advice where rights to safeguarded benefits are being given up for flexible benefits or an uncrystallised

funds pension lump sum. People with 'safeguarded benefits' (i.e. benefits which are neither money purchase nor cash balance under the definitions in pensions legislation) will continue to be allowed to transfer their benefits (subject to certain restrictions in relation to public sector schemes). But the Act introduces a requirement for trustees or managers of schemes to check that members have taken appropriate independent advice before transferring or converting such rights into rights which can be accessed flexibly, and before paying an uncrystallised funds pension lump sum in respect of safeguarded benefits. This safeguard will ensure that members have properly considered the implications of giving up the element of guarantee attached to safeguarded benefits in these circumstances. At the same time regulations made under the Act can ensure that the cost of appropriate independent advice is paid for by an employer where appropriate. This cost is exempt from being treated as a taxable benefit in kind for income tax purposes, provided specific conditions are met.

Drawdown, conversion of benefits and lump sums

10. The Taxation of Pensions Act 2014 makes changes to allow new forms of 'authorised payments' for tax purposes, the circumstances under which funds that may be designated as drawdown funds can be extended and the payment of lump sums from uncrystallised benefit rights under a money purchase arrangement (as defined in section 152 of the Finance Act 2004) will be permitted. As the definition of "money purchase benefit" is narrower under pensions law, the Pension Schemes Act 2015 defines the benefits to which these new flexibilities apply as 'flexible benefits'. These are money purchase benefits, cash balance benefits and any benefit which falls within the definition in section 152 of the Finance Act 2004, but contains some other element of guarantee which means that it is neither a money purchase benefit nor a cash balance benefit for the purposes of pensions law.

11. Cash balance arrangements are like money purchase arrangements, in as much as they provide a fund to the member but, unlike a money purchase arrangement, a cash balance arrangement includes some element of guarantee, such as a guaranteed interest rate or guaranteed amount.

12. The Act deals with the changes required in pensions legislation consequent on the changes in the Taxation of Pensions Act 2014, to ensure the new tax flexibilities work smoothly with pensions legislation.

Transfers

13. The Act also extends the current transfer rights for scheme members with 'flexible benefits', giving them a right to transfer up to and beyond their scheme's normal retirement age, and amends existing statutory transfer rights so that they apply in relation to benefit categories, rather than at scheme level.

14. As noted above, the 2014 Budget announcement indicated that savers would be given greater choice about how and when they access their defined contributions pensions pots. The new flexibilities will also have implications for those with a defined benefits pension pot, and the Treasury have consulted on how these flexibilities, including individuals' rights to a transfer, should be managed. As the majority of public service defined benefits schemes operate on an unfunded basis, allowing transfers out of these schemes would expose the Exchequer to significant risks. Therefore the Act restricts transfers out of certain public service defined benefits pension schemes.

15. The Act also introduces a power for Ministers to require the cash equivalent transfer value for transfers from funded public service schemes to schemes from which flexible benefits can be obtained to be reduced, in circumstances where the relevant Minister reasonably expects that such transfers, either singly or in combination with other factors, will significantly increase the risk or level of payments out of public funds to support the pension scheme to meet its liabilities.

Other measures

16. The Act also covers a number of miscellaneous provisions on other private pensions matters.