These notes refer to the Pension Schemes Act (Northern Ireland) 2016 (c.1) which received Royal Assent on 15 January 2016

Pension Schemes Act (Northern Ireland) 2016

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 1 – Categories of Pension Scheme

Section 1: Introduction

Section 2: Defined benefits scheme

Section 3: Shared risk scheme (sometimes known as "defined ambition")

Section 4: Defined contributions scheme

These sections define three new categories of pension scheme, which are: defined benefits scheme; shared risk scheme (sometimes referred to as 'defined ambition'); and defined contributions scheme. These categories apply only where legislation expressly states that they should, and do not apply in any public service pensions legislation.

The Pension Schemes Act currently defines a "money purchase scheme" as a scheme which offers, or may offer, only money purchase benefits. A money purchase benefit is generally taken to mean one which is derived from a pot of contributions, together with any investment returns on those contributions. The legislative definition of a money purchase benefit is a "benefit 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". The 2012 Act added a stipulation that a benefit (other than a pension in payment) is only money purchase if "its rate or amount is calculated solely by reference to assets which (because of the nature of the calculation) must necessarily suffice for the purposes of its provision to or in respect of the member".

Schemes which fall outside this definition are not generally defined in pensions legislation but are simply considered to be "non-money purchase".

Sections 2 to 4 define three mutually exclusive categories of pension scheme. These categories are based on the type of promise the member has during the accumulation phase about the retirement benefit (income or pot). The first category is a defined benefits scheme (section 2). This type of scheme provides a pre-determined retirement income to all members, beginning at the scheme's normal pension age or decumulation point and continuing for life[1]. This income is predetermined insofar as it is set at a rate that is calculated according to promised factors as stipulated in the scheme rules or other scheme documentation. This is expressed as a "full pensions promise" to members. The normal pension age or earliest occasion for accessing the full benefits is fixed – that is, the only way the age or period of accumulation can change is by change to the scheme rules. Schemes where the normal pension age changes in line with state pension age, without requiring a change to the scheme rules, are thus excluded. Also excluded are schemes which apply a longevity factor to the benefit entitlement. Regulations may prescribe additional requirements which must be met for a scheme to fall within the defined benefit category.

The second category is a shared risk scheme (section 3). This type of scheme offers a "pensions promise" to all members at some point during the accumulation phase in relation to at least some of the retirement benefit that members might receive, whether this benefit is given in the form of a retirement income or a retirement lump sum.

The third category is a defined contributions scheme (section 4). This type of scheme gives no promise during the accumulation phase in relation to any of the retirement benefits that may be provided to members.

The definitions therefore describe the extent to which members receive a promise during the accumulation phase: a defined benefits scheme is a scheme which provides a full pensions promise to members about all benefits to be provided; a shared risk scheme provides a pension promise about at least some of the benefits to be provided by the scheme; and a defined contributions scheme provides no pensions promise during the savings period. For further definition of "pensions promise" and related terms, see section 5.

The following schemes provide examples for each of the categories. These are not exhaustive but are for illustration:

- a salary-related pension scheme where the retirement income to be paid out is determined according to a formula based on a salary: for example, 1/80 x average salary x years in pensionable service. The age or point at which this income can start to be paid in full to members can only be changed by a change to the scheme rules. This is a defined benefits scheme.

- a pension scheme into which the employer and employee pay contributions. These contributions are then invested, and so the retirement benefit in part depends on how those investments perform, but some contributions are used to purchase a deferred annuity or otherwise secure a promise about part of the income that will be received in retirement. The retirement benefit received is a combination of that promise and the funds accumulated via contributions and investment returns. This is a shared risk scheme.

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1 For example, some schemes might not have a normal pension age but might have a specific period of service defined by accumulation period.

- a pension scheme into which the employer and employee pay contributions, which are then invested. The retirement benefit depends wholly on the money contributed to the scheme and the investment return, and potentially any pooling of risk between members, and so the employee is given no promise or certainty during the accumulation phase. This is a defined contributions scheme.

For a scheme which does not fit into any of the categories, regulations must be made to treat the scheme as two or more schemes which do fit into the categories (see section 6).

Section 5: Meaning of "pensions promise" etc

This section explains what is meant by the terms "pensions promise" and "full pensions promise".

Subsection (1) states that (for the purposes of defining a defined benefits scheme), there is a "full pensions promise" provided to members, if, at all times before the benefit comes into payment, there is a promise about the level of benefit that will be received and the level of benefit is determined wholly by reference to that promise in all circumstances. (*Subsection (3)* contains more about what a promise about the level of benefit consists of.)

Subsection (2) states that (for the purposes of defining a shared risk or defined contributions scheme), a "pensions promise" is provided if there is a promise to members during the accumulation phase, in relation to a retirement benefit, about the level of benefit that will be received. The level is the rate of the income or the amount of the lump sum (see section 7). The promise must be expressed at a time before the benefit comes into payment, but unlike under a defined benefits scheme, does not need to be expressed at all times before payment, i.e. throughout the accrual phase.

Any pensions promise about a level of retirement benefit includes a promise about the factors that will be used to calculate the level of a retirement benefit (subsection (3)(a)). These factors, may, for example, include the length of pensionable service, or be linked to the member's salary, but do not include longevity factors. A promise that the level of retirement benefit will be calculated by reference to what the pot of contributions or investment returns can provide does not constitute a 'pensions promise' for the purposes of defining a defined benefits or shared risk scheme (subsection (3)(b)). Neither is it a promise where a scheme specifies the factors that will be used to distribute the assets between members and establish the value of a collective benefit (subsection (3)(c)).

A pensions promise is provided if the scheme sets out the promise, or if it requires the promise to be obtained from a third party. This enables a pension scheme to be defined on the basis of the member's experience of whether there is a pensions promise, regardless of whether it comes from the scheme itself, the employer or a third party.

Subsection (5) provides that, in relation to a shared risk or defined contributions scheme, there is also a promise if the scheme offers the option of a promise (or the option of requiring a promise). This means that the scheme categorisation depends on what the scheme offers to members, not the offer that individual members take up. Should a scheme offer a money purchase pension with the option for members to purchase a guarantee, because there is the potential for a pensions promise to be given, this scheme would be defined as a shared risk scheme.

Subsection (6)(a) states that discretions to vary the benefit do not affect a scheme's categorisation where it would be considered otherwise as offering a "full pensions promise". This is providing that the discretions are capable only of being used for reasons related to a member's individual circumstances and meet other requirements that may be specified in regulations. For example, a defined benefits scheme may make provision for early retirement on the grounds of ill health, on a case-by-case basis, without it affecting the categorisation of the scheme under the new definitions. Since these discretions are exercised only on an individual basis, they are different from discretions applied at the scheme level.

Subsection (6)(b) states that a scheme may also offer other discretions in relation to retirement benefit without affecting its categorisation as a defined benefits scheme, as long as those discretions are of a description specified in regulations.

Subsection (7) provides that certain promises about the level of retirement income are not to be counted as pensions promises if they are only given within a specified period of that income coming into payment and are conditional on it coming into payment by a particular date. This is to cater for defined contributions schemes which also provide a retirement income stream, and make a promise only shortly before the point of decumulation, about that income. Such schemes will need to discuss and make a commitment to the member about that retirement income before the first payment is made, but will usually only make the promise in relation to the final pot and only in the immediate run up to the retirement date, so it provides no more certainty to the member than other defined contributions schemes. This subsection enables this type of scheme to remain defined contributions. It does this by excluding from the definition of "pensions promise" promises which meet a four part test: that the promise is about the level of income; that promise is conditional on the income coming into payment by a certain date; that the promise is first given during a period in the run-up to that date (with the length of that period to be specified in regulations); and that it is not a promise of a specified description (to ensure that where a scheme makes a promise within the prescribed period which does give the member greater certainty, this will be counted as a pensions promise - for example, where a promise is made about an income before the sum total of the savings is known).

Subsection (8) states that, when working out whether there is a particular kind of promise in relation to some or all of the benefits that may be provided as set out in sections 2 to 4, account must be taken of benefits which may be provided only after the member has been a member of the scheme for a certain length of time and any other benefits that may be provided to the member at a future time – for example, where members start in a scheme with money purchase benefits and no promise, but then after a certain number of years or at a certain age start accruing benefits to which a promise attaches.

Section 6: Treatment of a scheme as two or more separate schemes

This section requires regulations to be made for a pension scheme that does not fit within any of the categories set out in the sections above (it is not a defined benefits, defined contributions or shared risk scheme) to be treated as if it were two or more separate schemes, each then fitting within a category, for the purposes of these definitions and other specified legislation.

An example of such a scenario would be where an existing scheme has a defined benefits section which is not open to new members, and a defined contributions section for new members. This type of scheme would not be defined as a shared risk scheme, since, though there are some elements of a pensions promise, the promise is not available to all members. Instead, regulations must be made providing for the scheme to be treated as if it were two schemes for the purpose of the categorisation – in the example given above, it is likely that the power would be used to treat the scheme as if it were a defined benefits scheme and a defined contributions scheme.

The section also enables regulations to be made to provide for other circumstances in which a scheme can be treated as two or more schemes, each fitting within one of the scheme categories.

Section 7: Interpretation of Part 1

This section defines the terms for the purposes of Part 1.

"Normal pension age", in relation to retirement benefits, refers to the earliest age at which, or occasion on which, the pension scheme member is entitled to receive benefits from the scheme without adjustment for taking benefits early or late. If there is no such age or occasion, "normal pension age" will be the normal minimum pension age as defined by section 279(1) of the Finance Act 2004 – that is, before 6th April 2010, age 50, and on or after that date, age 55. A "fixed" normal pension age means a pension age (or other decumulation occasion) that cannot be changed except by an amendment to the scheme rules.

"Pension scheme" has the meaning given by section 1(5) of the Pension Schemes Act – that is, as "a scheme or other arrangements comprised in one or more instruments or agreements, having or capable of having effect so as to provide benefits to or in respect of people: on retirement; on having reached a particular age, or; on termination of service in an employment".

"Retirement benefit" refers to the benefit that a member of a pension scheme receives, which can be provided either in the form of a "retirement income" or a "retirement lump sum".

"Retirement income" is a pension or annuity payable to the member on reaching normal pension age. A "retirement lump sum" is a lump sum which is payable to the member on reaching normal pension age or made available for the provision of other retirement benefits on or after this time (this may include the purchase of an annuity).