

PENSION SCHEMES ACT 2015

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 1 – Categories of Pension Scheme

Section 5: Meaning of “pensions promise” etc

43. This section explains what is meant by the terms ‘pensions promise’ and ‘full pensions promise’.
44. 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.)
45. 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.
46. 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)).
47. 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.
48. 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.

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

49. Subsection (6)(a) states that certain 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 these 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.
50. 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.
51. 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).
52. 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 can 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.