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

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

33. 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.

34. The Pension Schemes Act 1993 defined a 'money purchase scheme' as a scheme which offers or may offer only money purchase benefits. A money purchase benefit is generally 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 Pensions Act 2011 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'.

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

36. 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).

37. 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 pre-determined 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

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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.

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.

38. 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.

39. 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.

40. 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.

41. 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.

- 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.

42. 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).