The Pension Schemes Act 2015 offers up the prospect of new scheme designs, but will initially be remembered, along with the Taxation of Pensions Act 2014, for bringing in the new pension tax freedoms.

This guide, published shortly after the Pension Schemes Act received Royal Assent, sets out and comments on the Act's key provisions, with the aim of assisting trustees, employers and scheme managers understand the legislation made so far and the actions that they may need to take.
1. An overview of the changes

The Pension Schemes Act 2015 seeks to do three main things – make changes to legislation sponsored by the Department for Work and Pensions (DWP) to assist the pension tax freedoms introduced in the Taxation of Pensions Act 2014; create a regulatory space for schemes that share risk between members and other parties; and enable new schemes to be set up that share risk between members.

The first, along with the necessary regulations, needs to be in place by 6 April 2015. The DWP aims to activate the second and third (including the required secondary legislation and any additional tax changes) by 6 April 2016.

LCP comment

The provisions relating to the pension tax freedoms will all be in force this side of the General Election and are likely to prove hard for a future Government to unwind. By contrast, the two aspects of this Government’s risk sharing agenda contained within the Act are much more susceptible to a change in policy direction and so might never be commenced.

In this guide we first look at the legislation relating to the pension tax freedoms. We then go on to describe the risk sharing legislation.

2. Flexible benefits and safeguarded benefits

Cornerstones of the new flexible pension regime are the terms “flexible benefits” and “safeguarded benefits”.

A “flexible benefit” is defined (for a member or survivor) as:

- a money purchase benefit;
- a cash balance benefit; or
- a benefit, other than the two above, calculated by reference to an amount available for the provision of benefits to or in respect of the member (whether calculated by reference to payments made by the member or any other person in respect of the member or any other factor).

Taken together, the intention is that these three benefits are equivalent to the benefits that can be delivered through a money purchase arrangement under tax law, which in turn can access the new pension tax flexibilities within the Taxation of Pensions Act 2014.

The Act also defines a “safeguarded benefit” as any benefit other than a money purchase benefit or a cash balance benefit. So, for example, a final salary benefit is a safeguarded benefit.

LCP comment

These two definitions are key to an understanding of the operation of the pension tax freedom part of the Act. The DWP applies the new DC freedoms to “flexible benefits” whilst putting in protections in relation to the conversion of “safeguarded benefits” to “flexible benefits”.

3. Pensions guidance

The Act devotes an entire Schedule to what is now branded as “Pension Wise”; the pensions guidance service providing what was known as the “guidance guarantee”. It outlines the guidance available to help a pension scheme member or survivor decide what to do with their flexible benefits. It names the Citizens Advice Bureaux and the Pensions Advisory Service as providers of “Pension Wise”. Citizens Advice will be responsible for face to face guidance across the UK, whilst the Pensions Advisory Service will be responsible for providing guidance on the telephone. Online guidance is being developed by HM Treasury, drawing on expertise from the Government Digital Service and the Money Advice Service.

It will be a criminal offence for a person to falsely claim to be, or to behave in a manner that might indicate they are, giving pensions guidance under Pension Wise.

The Schedule also sets out the role of HM Treasury and the Financial Conduct Authority (FCA). Amongst other things the FCA must:

- set standards for the giving of pensions guidance by the designated guidance providers;
- maintain arrangements for monitoring compliance by the designated guidance providers;
- make rules regarding who pays for HM Treasury and the FCA’s pensions guidance costs; and
- make general rules requiring information about the availability of the pensions guidance service to be given by the trustees or managers of a relevant scheme to members (and survivors of members) with any flexible benefits.

LCP comment

The Schedule does not go into any detail as to what the guidance service actually is; an outline is set out by the FCA in its “near final standards” in Policy Statement PS14/17, with the detail to be filled in by the guidance providers.

4. Disclosure of Information

The Act is largely silent about changes to the disclosure legislation to assist those with flexible benefits as the necessary powers have already been taken in previous Acts.

Regulations are to contain the important detail, including:
- giving information to members who have an opportunity to transfer their flexible benefits;
- giving information on the pensions guidance service;
- providing information about the value of the member’s flexible benefits where they are transferable; and
- providing appropriate warnings.

The purpose of these disclosures is to enable the member to take an informed decision in relation to accessing his or her flexible benefits (with or without use of the guidance service).

LCP comment

Pointing individuals to the pensions guidance service and supplying them with the things they need is vital to ensure that the new regime for flexible benefits works, but schemes will have next to no time to do this as the new disclosure regime will start to apply on 6 April 2015.

5. Appropriate independent advice

The trustees or managers of a pension scheme must check that a member (or survivor) with safeguarded benefits has received “appropriate independent advice” before taking certain actions. These actions are:
- converting the safeguarded rights into flexible benefits;
- making a transfer (under the cash equivalent laws or otherwise) to another pension scheme to acquire a right or entitlement to flexible benefits; or
- paying an uncrytallised funds pension lump sum (UFPLS) in respect of a safeguarded benefit that is also a flexible benefit.

This advice must be given by an “authorised independent adviser”, who must meet certain requirements.

Regulations are to:
- set out what the trustees must do to check that the member or survivor has received this advice and when the check must be carried out; and
- create an exception to the requirement to obtain advice where the cash equivalent value of the safeguarded benefits under the scheme is worth less than £30,000.

The Act enables regulations to be made requiring an employer, in certain specified circumstances, to pay for the appropriate independent advice. These regulations may impose limitations on the amount that the employer may be required to pay and prohibit the employer from seeking to recover any costs they incur from a member or survivor.

The Act provides that the cost of this advice will not be treated as a taxable benefit in kind for income tax purposes so long as the cost is for this purpose, is not in relation to a “relevant salary sacrifice arrangement” and meets such other requirements as may be set down in regulations.
Although the independent advice requirements apply beyond individual transfers out, it is to these that they are likely to have the greatest impact. Trustees should be considering how they will deal with this further layer of complexity in the management of transfer requests from those with defined benefits.

6. Transfer values

The Act contains a number of measures in relation to transfers as a consequence of the Treasury’s flexibility proposals. The key change is that from 6 April 2015 the right to a statutory cash equivalent transfer arises if the member has:

- accrued rights to any “category” of benefits;
- the benefits have not crystallised;
- the member is no longer accruing rights to those benefits; and
- where the benefits are not flexible benefits the member stopped accruing those rights at least one year before “normal pension age”.

There are three permissible “categories” – money purchase benefits, flexible benefits other than money purchase benefits and benefits that are not flexible benefits. Under the new regime individuals will have a right to transfer one category of their benefits whilst leaving the other within the scheme. Indeed, they will be able to continue accruing benefits in the category they have left behind despite transferring out a different category of benefits.

A member will usually lose the right to transfer non-money purchase benefits if they do not apply within three months of the guarantee date on the transfer quote. A member also loses the right to transfer if, after making an application, the trustees cannot confirm that appropriate independent advice (where required) has been taken within six months of the guarantee date.

There is no change to the manner in which cash equivalent transfer values must be calculated.

The key change is that from 6 April 2015 the right to a cash equivalent operates on a category basis. The main beneficiaries will be those with money purchase benefits (such as AVCs) alongside non-money purchase benefits – they will be able to transfer the former to a new destination where they can access the new freedoms, whilst keeping the latter within the scheme (they can separately transfer these too, but subject to advice).

7. Delivering the new DC flexibilities within occupational schemes

The Act also, through the use of DWP overriding powers, enables occupational pension schemes to provide directly for the new DC flexibilities. These overriding powers will only be available for flexible benefits. In particular:

- Occupational pension schemes may only pay drawdown pensions for members and survivors (including nominees or successors) out of money purchase assets held for each separately. This applies to assets designated as available for payment of drawdown on or after 6 April 2015.
- Regulations are to provide that flexible benefits which are not money purchase can be converted into money purchase benefits to pay a drawdown pension, provided an occupational scheme offers that option.
- Regulations are to provide for the payment of lump sums by occupational pension schemes in respect of non-money purchase flexible benefits.

Regulations will fill in details including whether the overriding powers require employer consent and whether trustees can charge members who wish to use any flexibility options within the scheme.

Right now, these overriding provisions are a “nice to have”. Most schemes will be focussing on what they have to deliver by 6 April 2015, rather than what they may wish to make available as their part of the new pension tax freedoms.
8. Sharing risk between members and other parties

We now move away from the pension tax legislation to cover that part of the Act that addresses the Government’s risk sharing agenda.

The Act divides all pension schemes (both existing and future, occupational and personal) into three mutually exclusive categories – “defined benefits”, “defined contributions” and “shared risk” (which the Act also references as “defined ambition”).

The rationale for this new division is in order to create a new regulatory space for schemes that share risks between members and other parties – typically employers, but it can be wider than this.

The terms “defined benefits” and “defined contributions” may seem familiar, but from 2016 they will have a slightly different meaning:

- Defined benefits schemes are broadly the very strictest definition of defined benefit – there will be no money purchase benefits included in the scheme and the normal pension age cannot be linked to how long members are expected to live. There is a full promise about the level of benefits at all times before payment.

- Defined contributions schemes are a slightly wider group than “money purchase” schemes. Broadly, any schemes that are completely money purchase before any benefits are put into payment will be classed as defined contributions schemes – there should be no promise about the level of benefits before payment.

And everything in the middle is expected to be “shared risk”. For these, there should be some promise about the level of benefits before payment, but they are not a defined benefits scheme.

It seems inevitable that some types of existing scheme will find themselves effectively reclassified under one of these new definitions. For example, the following are likely to be regarded as “shared risk” schemes:

<table>
<thead>
<tr>
<th>Schemes likely to be regarded as “shared risk”</th>
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<tbody>
<tr>
<td>Cash balance schemes</td>
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<tr>
<td>Defined benefit schemes under which normal pension age can vary in line with longevity gains</td>
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<tr>
<td>Defined contribution schemes with an investment guarantee</td>
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<tr>
<td>Defined contribution schemes with a money back guarantee</td>
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<td>A scheme in which contributions purchase internalised with profit deferred annuities</td>
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Some moderate level of re-categorisation is appropriate and meets one of the objectives of the overall policy, ie to inform members about the risks they face in their pension scheme. However, there are very few consequences of being categorised as a “shared risk scheme”.

There is also little by way of consequence through schemes being classified as either a “defined benefits scheme” or a “defined contributions scheme”. Some schemes may find themselves subject to different auto-enrolment quality requirements as a result of a change in classification, but most schemes are likely to notice no change at all.

There will be schemes that are considered as two separate schemes for the purposes of this classification. For example a predominantly defined benefits scheme with some defined contribution AVCs will be dealt with separately as a defined benefits and a defined contributions scheme.

LCP comment

One might be forgiven for asking why the Government has put through this legislation when it is to have so little impact. The answer is that it is just “paving” legislation, preparing the pensions ground for more significant changes whose purpose is to encourage a third way of employer sponsored retirement provision. But right now, there is little, if any, encouragement for employers to develop novel forms of shared risk schemes. There is also a positive disincentive – amendments will be needed to tax legislation to provide appropriate methods for testing benefits from new scheme designs that are classed as “shared risk” against the annual and lifetime allowances. The current methods of testing against allowances may give inappropriate tax outcomes.
9. Sharing risk between members

To enable collective defined contribution (CDC) schemes to come into existence, the Act creates a new category of “collective benefit”. A benefit is a collective benefit if it depends entirely on:

- the amount available for the provision of benefits to or in respect of the member and one or more other members collectively; and
- factors used to determine what proportion of that amount is available for the provision of the particular benefit.

Such a benefit will typically meet the requirements to be a benefit within a “defined contributions scheme”. But as these benefits share risk between members they cannot be classed as “money purchase benefits”.

The Act sets out a new regulatory framework within which such benefits will need to operate. But there is no flesh on these bones; just a series of powers under which regulations can be made to fill in the detail.

Amongst other things the framework requires the setting of targets and the assessment of the probability that the scheme meets those targets. Where that probability falls outside a required range, trustees may be required to have a policy for dealing with a surplus or deficit.

LCP comment

The Act seems to create a workable and practical framework for collective benefits, although the drafting of the regulations will be key. One clear concern is that some of the gains that may be achievable from a collective benefit scheme may be lost through an over-cautious investment strategy driven by the need to meet the scheme’s target level of benefits with a high probability.

10. Final word

The Pension Schemes Act 2015 has been put through Parliament at high speed, with its content and structure undergoing significant change during this process. What has been delivered are the absolutely necessary changes to facilitate the new pension tax freedoms in occupational schemes along with a clear statement of this Government’s intent on risk sharing. More legislation and guidance will now follow, in short order, to complete the delivery of the former, much of which will need immediate action by schemes. It is going to be a very busy time for occupational schemes as they adjust to the Chancellor’s pension revolution.

This guide should not be relied upon as advice, nor taken as an authoritative statement of the law.