Department for Work & Pensions

Pension Schemes Bill 2014 to 2015 narrative

Introduction

Together with the Taxation of Pensions Bill, the Pension Schemes Bill introduces a radical reform of pensions. Giving people greater choice is at the heart of the reforms in the Bill: greater choice for business on the pensions they offer (by encouraging and enabling ‘Defined Ambition’ - or ‘shared risk’ - pension schemes and ‘collective benefits’) and greater choice for individuals on how they can access their pension savings (through the new pension flexibilities announced in the Budget 2014).

The time is right to make these fundamental and radical changes to private pensions legislation, building on the major progress already made on pension reform. The new State Pension will provide a simplified foundation, making it easier for people to know what pension they will be receiving from the State and therefore providing a platform on which individuals can build their own private pension savings according to their wants and needs in retirement. The introduction of automatic enrolment means that millions more savers are joining workplace pension schemes. This Government has also taken forward other changes so that the future private pension landscape delivers high quality, value for money pensions for consumers. For example, from April 2015 there will be a charge cap in the default funds of qualifying schemes (schemes used for automatic enrolment) and new requirements for Independent Governance Committees and trustees to report on costs and charges.

The market is therefore growing and employers and the pension industry are already thinking about future pension provision. The Bill will build on the reforms, seeking to encourage a flourishing private pensions market that provides greater choice for business and individual savers.

Defined Ambition pensions

Current legislation is broadly based on a binary structure of money purchase or non-money purchase benefits. While both of these types of pension can be the right product for many, the Pension Schemes Bill seeks to encourage pension designs that share risks so that neither the individual saver nor the employer takes on the full financial risk.

Salary related pension schemes – sometimes known as Defined Benefit – have been in decline since the 1970s and the majority are now closed to new members. There has been a long term shift to schemes commonly known as Defined Contribution as many employers have found the increasing costs and volatility of longevity and investment risk too heavy to bear. However, if Defined Contribution schemes are the only alternative then outcomes for savers will be less certain and more volatile than for earlier generations, making it much harder for future generations of savers to plan for later life.

The Defined Ambition elements of the Bill are a reshaping of pensions legislation to ensure it remains relevant for future generations - to reflect, recognise and reinvigorate innovation in consumer focused product design in ‘shared risk’ pensions. The Bill introduces three new definitions – three categories of pension scheme based on the type of promise that the scheme provides to savers during the saving phase about the benefits that will be available to them at retirement. This is in order to create a middle ground which we call Defined Ambition, between the more polarising money purchase and non-money purchase benefit definitions to encourage innovation in pension design that provides for more certainty for individuals than Defined Contribution pensions – by sharing risks between employers, employees and third parties.

The Pension Schemes Bill will also enable ‘collective benefits’ to operate in the UK. The collective benefit definition enables a new form of risk pooling between scheme members that can provide greater stability in outcome for members. We have engaged extensively with stakeholders across the pensions industry and consumer groups and found that there is appetite for legislation that allows for greater risk sharing and risk pooling.

The Pension Schemes Bill has been informed by extensive stakeholder engagement and consumer (employer and member) research. Overall, the evidence demonstrates demand from consumers for Defined Ambition Schemes and Collective Benefits. Consumers consistently show considerations such as aversion to loss, limited appetite for risk and the desire to have more certainty about what long term pension saving will achieve. Defined Ambition speaks to these considerations.

Pension flexibilities announced in the Budget

This Government is committed to giving people freedom and choice about how they use their pension savings. This Bill, along with the Taxation of Pensions Bill, will mean that from April 2015, individuals from the age of 55 in a Defined Contribution arrangement will be able to access this pension flexibility if they wish, subject to their marginal rate of income tax (rather than the current 55% tax charge). The Taxation of Pensions Bill will legislate for the required tax regime changes, and this Bill will make the required changes to pensions legislation. This will include a guidance guarantee that means everyone with a Defined Contribution arrangement is offered free, impartial guidance so they are clear on the range of options available to them at retirement. There will also be a duty on providers and schemes to ensure eligible members are made aware of this service and signposted to it.

The Government will continue to allow members of private sector and funded public service schemes to transfer their accrued benefits to other types of schemes, if they wish to. In the majority of cases it will continue to be in the best interests of the individual to leave their accrued benefits within their existing scheme. Therefore two additional safeguards will be introduced to protect individuals and schemes. Firstly, if a member exercises their right to ask for a transfer of benefits other than money-purchase or cash balance benefits they must take advice from a financial adviser before a transfer can be accepted by the new scheme. Secondly, the Pension Regulator will issue new guidance for trustees of Defined Benefit schemes on the use of their existing powers to delay or reduce a transfer value and take account of scheme funding levels. To protect the Exchequer and tax payers, transfers out of unfunded public service Defined Benefit schemes will not be allowed (except in very limited circumstances).

The Defined Ambition and pension flexibilities reforms are about putting the saver first and addressing people's desire for greater certainty about income in both the savings and pay-out phases. The Defined Ambition legislation will not restrict individuals from accessing the new Budget pension tax flexibilities. There will often be more than one type of benefit arrangement within a Defined Ambition scheme and the policy intent is that members will be able to access those arrangements in line with the new flexibilities, which may be addressed in later legislation. The fact that they are contained in a particular category of scheme will not have any impact on that access. Similarly, the policy intent for members of members of schemes offering collective benefits will be able to cash out their collective benefits. Measures to provide for this will be considered in the future. While there may be different requirements on the scheme in terms of the advice or guidance that must be offered for different types of benefit arrangement within the scheme, the individual will have the choice over what to do with their savings.

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Pension Schemes Bill: overview

Part 1 – Categories of Pensions Scheme

- This Part of the Bill contains provisions for a new framework in relation to the categorisation of pension schemes.
- It establishes three, mutually exclusive categories of pension scheme based on the "pensions promise" provided to members, during the accumulation phase of saving, about the benefits that will be available to them at retirement.
- Defined Benefit - full pensions promise relating to the full income from the scheme
- Shared Risk (Defined Ambition) - a promise about part of the income or savings,
- Defined Contribution - no promise during the savings period about the level of income or savings.
- The Bill provides for regulations to be made so that a scheme can be treated as more than one scheme for the purposes of categorisation, in relation to different promises to members.

Part 2 – General Changes to Pensions Legislation

- This Part broadly contains amendments to existing legislation as a consequence of the change to scheme definitions set out in Part 1.
- It ensures the current legislative requirements apply in the appropriate way to the new categories and adds a provision to enable regulations to set out the conditions to be satisfied by any third party guarantees obtained by schemes.
- It also provides a regulation-making power to restrict transfers from public service defined benefits schemes into a defined contribution arrangement, and removes the statutory requirement for regulations to provide that the Pensions Regulator compile and maintain a register of trustees (to fulfil a DWP commitment to the Red Tape Challenge).

Part 3 – Collective Benefits

- This Part defines the concept of collective benefits and makes provision for regulation-making powers in relation to them. These powers cover matters such as the setting of targets in relation to benefits, valuation, reporting requirements and governance.

Part 4 – Miscellaneous and General

- This Part allows the Secretary of State to make payments into the Remploy Limited Pension and Assurance Scheme directly, rather than indirectly through the payments he makes to the wider Remploy organisation.
- It also contains a power to make consequential amendments and makes general provision in respect of regulations, the Territorial Extent of the Bill, Crown application and commencement.

Flexibilities in how people access pension savings

Overview

- The 2014 Budget announced new flexibilities in how people access their pension arrangements. A Government consultation ('Freedom and choice in pensions') was undertaken and the response to the consultation was published in July 2014.
- This Bill, along with the Taxation of Pensions Bill, will mean that from April 2015, individuals from the age of 55 with a Defined Contribution pension will be able to access this pension flexibly if they wish. This will be subject to their marginal rate of income tax (rather than the current 55% tax charge for full withdrawal) and scheme rules.
- Those who want the security of an annuity will still be able to purchase one. Those who want to access all of their Defined Contribution pension savings will be able to take them as a lump sum. Those who want to keep their savings invested and access it over time will be able to purchase a drawdown product.
- The Taxation of Pensions Bill will legislate for the required tax changes and was introduced to parliament on 14 October. Draft clauses for the Tax Bill, along with supporting documents, were published for technical comment in August 2014.
- Government amendments to the Pension Schemes Bill will be brought forward to make the required changes to pensions legislation so that the new flexibilities operate as intended.

Guidance

- Every individual with Defined Contribution pension savings will have a new right to free and impartial guidance as they approach retirement to help them make confident and informed decisions on how they use their pension savings in retirement.

- The guidance will be tailored to individuals' personal circumstances, but will not recommend specific products or providers. To ensure that this guidance is completely impartial, it will be provided by independent organisations that have no actual, or potential, conflict of interest.
- The Government is legislating to give the Financial Conduct Authority (FCA) responsibility for setting standards for guidance and monitoring compliance with those standards. The FCA has just completed a consultation on its proposed standards.
- Pension providers and schemes will be required to ensure that they make people aware of their right to impartial guidance and signpost them to the guidance service as they approach retirement.
- Individuals will be able to access and use the guidance service in a range of ways, including the option of face-to-face.
- A new implementation team has been set up in the Treasury to ensure that the guidance service is up and running in good time for April 2015. This will bring together a range of organisations with relevant expertise and capability, including the Pensions Advisory Service and the Money Advice Service. The Government will publish a progress update on implementation later in the autumn.
- The Government will legislate to establish a levy on regulated financial services firms to fund the cost of the guidance service.

Transfers from Private Sector Defined Benefit Schemes

- The Government will continue to allow members of private sector Defined Benefit schemes the freedom to transfer to other types of scheme.
- For the majority, Defined Benefit schemes will remain the most appropriate option for them
- Additional safeguards will be introduced to ensure that the transfers process continues to work well, including a duty for individuals to take professional financial advice before they transfer from a Defined Benefit to a Defined Contribution scheme – to support them to make an informed choice about their options.

Transfers from Public Service Defined Benefit Schemes

- The Government will continue to allow members of funded public service Defined Benefit schemes to transfer to Defined Contribution Schemes.
- To protect the Exchequer and tax payers, transfers will not – other than in very limited circumstances - be allowed from unfunded public service Defined Benefit schemes into Defined Contribution arrangements.