Department for Work & Pensions

Pension Schemes Bill Information Note – Defined Ambition pensions and Collective Benefits

This legislation comes as a result of extensive stakeholder engagement and research, including development of models with industry working groups and analysis of responses to our consultation paper, Reshaping Workplace Pensions for Future Generations. We have found that employers would welcome the greater flexibility to create pension schemes that best suit the needs of their workforce while sharing risks more equally between parties. The research paper Defined Ambition pensions: consumer perspectives, published 26 June 2014 showed that, there was considerable enthusiasm for greater certainty of retirement income during the savings period. The DA concept introduced in this Bill was seen as a positive move towards this certainty.

The Pension Schemes Bill is a framework Bill. It sets out **new definitions of pension schemes** – Defined Contributions schemes, Defined Ambition (or 'shared risk') schemes, and Defined Benefits schemes. The definitions that the Bill establishes do not prescribe new requirements on schemes or describe specific benefits or scheme designs. Rather, the intent is that the high level scheme categories describe the defining characteristics of the different types of scheme. This is in order to create a clear space for the innovation of Defined Ambition schemes.

The Bill also establishes a **new definition of collective benefits** to enable the development of schemes with collective benefits which pool risk between members potentially creating greater stability of outcome compared to individual DC. The Bill sets out the type of requirements that will apply to those benefits to ensure transparency and robust governance of the scheme and management of its assets. The requirements will be set out in more detail in regulations, which we intend to develop in consultation with the industry and consumer representatives.

In this Bill, 'Shared Risk' scheme is not synonymous with 'collective benefits' – they have distinct identities.

New definitions

The categories defined in this Bill do apply to existing as well as new schemes, and to personal as well as occupational schemes.

The definitions in Part 1 of the Bill are based on the consumer perspective. They focus on the experience of the member about what certainty they have while they are saving regarding what they will get at or in retirement, regardless of which funding regime applies and the requirements on the parties involved in relation to the promises made.

The Defined Ambition category is one where the member has some certainty about what they will receive from the scheme, either the size of the pot or the income. Defined Ambition schemes are ones in which the member is not bearing all the economic risks of saving for retirement income – i.e. inflation, investment, and longevity risks. The Defined Benefit category is where the member bears none of the risk (other than, potentially, inflation risk insofar as this exceeds statutory revaluation and indexation requirements) in relation to their retirement income. The Defined Contribution category is where the members bear all of the risk during the savings period.

The Bill articulates this idea of the consumer experience of certainty by defining the meaning of ‘pension promise’ and ‘full pension promise’. “Promise” takes its normal meaning – a commitment to the provision of a certain thing, not merely intent or expectation. Scheme funding and capital adequacy requirements will apply where such promises are given under existing legislation.

The Part 1 definitions are at a scheme level. Schemes will continue to be made up of benefit level ‘building blocks’ (for example Money Purchase benefits, or benefits which are not Money Purchase, and now collective benefits – see Part 3). The definitions do not change the requirements that bite on different types of benefits under existing legislation, although some of the references in existing legislation have been updated to take account of potential new schemes in the Defined Ambition space.

The definitions in Part 1 and the collective benefit provision in Part 3 together set out a clear space for innovation and development of some of the schemes as discussed in the consultation document.

Collective benefits

Part 3 of the Bill sets out the provisions for schemes offering “collective benefits”.

The **collective benefit** definition is a benefit level definition, so it is possible to have collective benefits in a DC or a DA scheme. Because of the way in which collective benefit has been defined, it cannot offer a promise and therefore cannot place a funding obligation on an employer beyond the contribution level.

Collective benefits allow members to share and pool a range of different types of risk with other members, both in the accumulation phase and the pay out phase. Members share risk within a shared asset pool that can enable members of the pension scheme to smooth investment returns and economic shocks over more than one generation.

This can deliver the benefits of greater stability for members in projections of their likely pot size or income or in retirement, during the accumulation phase (compared with individual DC). It can also enable members to avoid exposure to short term market fluctuations that accompany a point at which a pot is converted into an income, as well as enabling schemes to pay a scheme pension directly to members out of the collective asset pool that avoids the need to purchase an annuity.

Part 3 of the Bill is seeking to enable schemes offering collective benefits to be set up in a variety of different vehicles, including in occupational pension schemes and personal pension schemes.

We are also seeking to enable a wide range of scheme designs, and so Part 3 makes a number of provisions and takes a series of regulation-making powers to allow us to specify the requirements for each phase of the life-cycle of a collective benefit in secondary regulations. The powers relate to key features of collective benefits. These are:

- We may require schemes to set a target for the level of benefit they are seeking to provide for the members in retirement. Targets are “unenforceable” and there can be no promise or employer liability in relation to a target. Targeted benefits can go up or down if needed to keep the fund in balance. We will not specify what the target is, but it must relate to all the assets in the collective pool.
- We may require schemes offering collective benefits to set targets at a level that ensures that they are able to be paid out with a level of probability to be set in regulations. We do not prescribe the probability level in primary and will consult on the detail of that figure, or a range of figures.
- We may require schemes to obtain a report valuing the assets held by the scheme and assessing the probability of the scheme meeting the targets in relation to those benefits. We may also require certain assumptions or methods to be followed by the actuary preparing the report.
- We may require schemes offering collective benefits to set out in advance a ‘policy for dealing with a deficit or surplus’ – i.e. if the scheme over or under performs in relation to the targets. Also, we may require the scheme to consult on this policy with members, and to follow this policy to adjust the benefit distribution between members when the scheme’s ability to meet its target benefits falls below or exceeds the probability to be set in regulations. (The valuation process

will trigger these provisions.) So that there is transparency for members, regulations may require the policy to contain an explanation of the possible effect of the policy on members in different circumstances.
- We may require schemes to prepare a statement of their investment strategy.
- We may require schemes to have a policy for calculating a Transfer Value should a member wish to leave the scheme, and to follow that policy.
- The key activities within schemes offering collective benefits will require actuarial certification, and regulations may require the reports prepared under part 3 to be published or sent to the regulator. Ensuring transparency for members is a key pillar of our approach to the operation of collective benefits.
- Within trust-based schemes, the trustees will already be under a fiduciary duty to act in members' best interests. We have also taken powers to require managers in non-trust based schemes offering collective benefits to act in members best interests when taking specified decisions. This might include for example discretionary decisions under the scheme policy for dealing with a deficit or surplus, or decisions about the pension to be paid to members on retirement.

Governance and disclosure

Part 2 contains some amendments to existing legislation. These are focused on ensuring existing requirements in relation to certain benefit types remain in place and are applied appropriately and some are updated to take into account how they apply in new schemes we envisaged in the shared risk space.

Defined Ambition schemes and those containing collective benefits may be more complicated than other schemes where the member is bearing all or none of the risk. Therefore we have also ensured we have appropriate provision for disclosure and governance requirements.

- We have also tabled a Government Amendment to require that certain decisions in shared risk schemes and in respect of collective benefits are made in the best interests of the members.
- The Bill contains a regulation making power in relation to conditions in respect of third party guarantees, and some small amendments to disclosure powers so that we can add additional parties to the disclosure requirement in regulations.
- Part 3 focuses on making provision about specific activities in the scheme that are key for good robust governance of the scheme, and transparency for members.
- We also have powers in other legislation which we intend to consider to introduce measures specifically in the shared risk space in relation to disclosure and governance:
    - Pension Schemes Act 1993 – section 113 – disclosure requirements
    - Pension Act 2014 – Schedule 18 – Governance requirements.

The benefit and scheme level requirements will be enforced by the appropriate regulator.

Members

Our research has shown that there is demand from members for more certainty than defined contribution and an appetite to pool risk in collective arrangements.[1] The definitions have been designed to focus on the member experience, and measures in Part 2, and 3, ensure appropriate protections.

Employers

Our research shows that employers' main concerns are about the volatility of funding and the reflection of the costs of the scheme in the balance sheet. Although we have not delivered legislative changes to enable some of the 'flexible Defined Benefit' designs in the consultation document or to remove requirements on current Defined Benefit schemes or non-Money Purchase benefits, there are other provisions that speak to these concerns.

For example, the definition of collective benefits by excluding the possibility of a promise draws a clear line between employer liability and the pension fund. We also intend to reinvigorate the Regulatory Own Fund regime to enable schemes to stand behind their own promises, to separate employer liability from any promises in the scheme. The Defined Ambition space also allows for promises made by third parties, which would mean the scheme and the employer do not bear the funding risk – it sits with a third party. Also, defining the new Defined Ambition category may potentially offer an opportunity in the future for targeting de-regulatory measures at a scheme category level.

This means employers can provide their employees with a pensions scheme which contains a promise or delivers greater stability of outcome than individual Defined Contribution, but without generating a requirement on the employer other than to pay in the contributions. There need be no deficit for the employer unless they choose to stand behind the promise themselves.

The reason why we have not legislated for the 'flexible DB models' is because responses to the Government's Consultation in November 2103 and the research findings indicated employers thought that for savings to be attractive enough to take up these measures, they must also apply to members' accrued rights, which was never the Government's intention.

[1] For more detail on appetite for reducing risk, please see the paper *Defined Ambition: Consumer Evidence Summary*, Section 5.1 Attitudes to risk and uncertainty. Available online at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/323248/defined-ambition-consumer-evidence-summary.pdf

Conclusion

Defined Ambition schemes and collective benefits together offer a response to proven consumer demand, and choice and opportunities for employers who wish to offer more than Defined Contribution pensions to their members, but without necessarily generating new liabilities for employers.

Timescale

The aim is for required secondary legislation and any additional tax changes to come into effect for April 2016, so that employers considering options at the time of the ceasing of contracting out have more options available to them than at present.