**Core Unit 1A – Understanding Retirement Provision**

**Assignment 4 Notes**

**(Part 4 – Workplace Pensions)**

**Recommended Time: 2 Hours**

1. **As a benefit consultant, you have been asked to write a report explaining what a personal pension scheme is and differentiating between personal pensions for individuals and personal pensions for groups of employees.**

**20 Marks**

Your answer should cover the following:

* A pension scheme which is not an occupational pension scheme;
* Established by a person with permission under FSMA 2000;
* Tend to be provided by insurance companies;
* Contract with the Insurer which will set out the terms of the scheme;
* Many employers operate a group personal pension scheme – collection of personal pension arrangements;
* Employer can name the scheme to give it the feel of an occupational pension scheme
* Lower administration charges;
* A management committee – like a board of occupational pension scheme trustees – group of skilled and knowledgeable people who meet up regularly to review the way the pension scheme is run. No contractual agreement and the provider is not required to follow the proposals;
* 6 April 2015, regulated firms are required to establish and maintain an Independent Governance Committee / GAA;
* Must be registered with HMRC to receive tax favourable treatment.

Individuals:

* Originally set up to anyone could join to save an income for retirement provided they had relevant earnings and from non-pensionable employment;
* Introduced from 1 July 1988 to replace retirement annuity contracts;
* Operate on a DC basis;
* Established under irrevocable trust, be deed poll or in Scotland by board resolution;
* Set up under trust may itself be under a master trust or may consist of individual trusts;
* Originally for the benefit of retirement, death, or disability for the self-employed;
* Rules relaxed in 1991 regarding simultaneous membership of occupational and personal pension schemes;
* 1980s Mis-selling scandal;
* April 2006 – restrictions on concurrent membership was removed altogether.

Groups of Employees:

* Employer wanting to make pension provision by using personal pensions;
* Collection of individual personal pensions – same provider;;
* Benefits of scale;
* Enhanced terms;;
* Employer will usually contribute and normally deductible against corporation tax;
* Branded with company name and logo;
* Contributions from members are from net earnings – net pay arrangement;
* Higher tax payers will have to reclaim further relief through their tax assessment or get their tax code adjusted.

(Relevant sections of the manual are Part 4 Chapter 1.2.1 & 1.2.2)

1. **Write short notes on Self-Invested Personal Pensions (SIPPs). Your answer must also refer to the term “Income Drawdown”.**

**10 Marks**

Your answer should cover the following:

* Introduced following a government initiative announced in the 1989 Budget;
* Making it easier for members to control their own pension fund investment;
* Finance Act 1995 introduced income drawdown which increased its popularity;
* Income drawdown allowed members to take an income which can vary year to year;
* Pre 6 April 2015, two types of drawdown – capped / flexible;
* Capped – maximum amount of income that could be taken but no minimum;
* Flexible – satisfy the minimum income requirement, lifted the maximum that could be taken;
* Works the same way as a normal personal pension plan, contributions paid, and benefits are relied upon amount of contributions and investment return;
* Downfall – been susceptible to pension scams.

(Relevant section of the manual is Part 4 Chapter 1.2.3)

1. **Briefly explain what a master trust is and the advantages it has over a Group Personal Pension arrangement.**

**5 Marks**

Your answer should cover the following:

* Usually trust-based DC occupation pension schemes for non-associated employers;
* Designed to be used in the same way as group personal pensions;
* Historically held over GPPs has been the ability to offer a refund of members’ contributions for leavers within 2 years - in some cases this could result in significant savings for the employer - this advantage was eroded by Pensions Act 2014 which bans short service refunds for joiners after 1 October 2015 with more than 30 days’ service;
* Flexibility in member communications compared with GPPs;
* Since 2018 all master trusts must be authorised and supervised by the Pensions Regulator.

(Relevant section of the manual is Part 4 Chapter1.2.8)

1. **Your pensions manager has asked you to prepare a paper explaining what a Defined Contribution Pension is and how this differs or shares similarities to a Cash Balance Pension scheme.**

**20 Marks**

Your answer should include the following:

Defined Contribution Scheme:

* DC basis / money purchase arrangements;
* Retirement benefits are determined by level of contributions paid in, which are then usually increased by investment return;
* The fund can increase or decrease depending on market conditions and is not possible to know in advance the overall return on the fund at retirement;
* The fund converted into income – historically by purchasing an annuity – usually depend on annuity rates available at member’s retirement date – another element of uncertainty;
* Lifestyle to mitigate this risk;
* Funding characteristics are opposite to those of a DB scheme;
* Cost of running the scheme highly predictable – contribution rates set out in the rules;
* Benefit not known in advance;
* New flexibilities – form of lump sum rather than annuities – April 2015;
* Examples – NEST, stakeholder pensions, occupational money purchase schemes, master trusts.

Cash balance scheme:

* DB scheme;
* Share some characteristics of money-purchase schemes;
* Contributions are paid each year by the employee and employer;
* Contributions are invested and at retirement the member is provided a lump sum which can be used to provide a pension;
* The cash sum is defined at the outset and does not depend on investment return;
* The employer will make up any shortfall;
* Lump sum can be defined and known in advance, but the amount of pension payable will depend on market conditions at retirement;
* For example, a company might set up a cash balance scheme and members are required to pay 5% of salary each year in return for a lump sum of 20% of final salary for each year of membership. Or alternatively, the rules might stipulate the contribution rate and the rate of investment return to be allocated;
* The cash value of the benefit at retirement is defined, the amount of pension that the member will receive is not known in advance and will depend on market conditions prevailing when the member retires. In this aspect, a cash balance scheme is more like a money purchase scheme than a DB scheme such as a final salary or CARE scheme

(Relevant sections of the manual are Part 4 Chapters 2.1.4 & 2.1.5)

1. **There are a number of types of risk associated with pension schemes, list and explain some examples of de-risking strategies.**

**15 Marks**

Your answer should cover the following:

Insurance type solutions:

* buy-out or buy-in - liabilities are either taken on by an insurance company or kept within the scheme;
* risk is reduced either by using conventional insurance policies such as annuities or by way of products such as longevity swaps.

Enhanced Transfer Value and Pension Increase Exchange exercises:

* enhanced or incentivised transfer value exercise - deferred pensioners who agree to transfer out to another pension scheme are offered an enhancement to the amount available for transfer;
* pension increase exchange exercise - pensioners offered a one-off increase to their pensions in exchange for giving up their rights to receive certain future pension increases.
* The Regulator has issued a principles-based statement on incentive exercises, giving brief guidance for employers, trustees and advisers. This refers to an industry Code of Good Practice, which sets out seven principles to be applied in such exercises. The Pensions Act 2014 includes a power (running up to 2021) for regulations to be made to prohibit incentives from being offered to members of salary-related occupational pension schemes in return for transferring out their pension rights. It was intended that the power would only be used if there is evidence of failure to follow the Code – so far no such regulations have been made.

Liability Driven Investment:

* aim of the investment strategy is to match the risk characteristics of the investments to those of the liabilities;
* has the effect of reducing amount of uncertainty in future funding levels of the scheme.

(Relevant section of the manual is Part 4 Chapter 2.2.1)

1. **Outline the features of a public sector scheme.**

**10 Marks**

Your answer should cover the following:

* A statutory occupational scheme;
* Provides benefits for the employees and former employees of central Government, local authorities and various public bodies, including employees of the health service, teachers, the police and former employees of nationalised industries;
* The pay-as-you-go system is used by many public sector schemes - benefits are payable from the public purse as they fall due, rather than from a fund built up from employers’ and employees’ contributions paid in the past and then invested;
* Pension age historically has usually been 60 for both men and women, and can be earlier (for example the police, fire fighters, and armed forces). However, from 2006, for new entrants to many public sector schemes, the pension age increased to 65;
* Pension is typically calculated as 1/80th of final pay for each year of service, with an additional lump sum of 3/80ths for each year;
* Ill health early retirement provisions can be more generous than the private sector;
* As a result of the Pensions (Increase) Act 1971, benefits accrued in many of the larger public sector schemes are fully ‘inflation proofed.’ Both pensions in payment and deferred pensions are guaranteed annual increases in line with price inflation. Originally, increases were aligned with the Retail Prices Index (RPI), but since 2011 the relevant index has been the Consumer Prices Index (CPI);
* Transfers of accrued rights between most public sector schemes are carried out on specified terms under the rules of the Public Sector Transfer Club. Periods of service accrued in one club scheme may frequently be reproduced exactly following a transfer to another.

(Relevant section of the manual is Part 4 Chapter 2.3.1)

1. **Your pensions manager is considering the possibility of an insured pension scheme and has asked you to write a report on this type of workplace pension scheme, namely what it is and the features involved.**

**20 Marks**

Your answer should cover the following:

* Benefits are provided by an insurance company under an insurance policy to which premiums are paid;
* Avoidance of risk can be reduced if selected with care and a suitable policy taken out;
* Large number of members – maybe no more than an investment vehicle for all or part of the assets of the fund;
* Small number of members – individual insurance contracts for each member;
* Insurance policy issued by the provider to the trustees as the policyholder and payable to them and not the member;
* Regulated under FSMA 2000 – extra security;
* Protection under the Financial Services Compensation Scheme if the provider goes insolvent;;
* However, there is a premium for this extra security;;
* The policy would be established to accept employer and/or employee contributions, either on a regular or single premium basis;
* Those contributions would then be invested into one or more of the funds offered by the particular insurance company. Such funds can either be those administered and managed by the insurance company itself or, increasingly these days, ‘external fund links’ may be offered, allowing contributions to be invested into funds that are managed by other investment managers;
* Insured schemes can be either bundled or unbundled;
* A bundled product is one in which all the contract, including the charge structure, covers all main components associated with the arrangement, principally investment management; Trustee services, including administration and communication; Insurance services;
* Where an insured scheme is unbundled, the different components are charged for separately or even provided by different organisations.

(Relevant section of the manual is Part 4 Chapter 2.3.4)