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

**Assignment 4 Notes**

**(Part 4 – Workplace Pensions)**

**Recommended Time: 2 Hours**

1. **Write short notes on occupational pension schemes, broadly what one is and their main features.**

**10 Marks**

Your answer should cover the following:

* Established by an employer to provide pensions and other ancillary benefits to its employees
* Administered in the UK
* Wide range of pensions – letter, complex schemes i.e. corporate group
* Most regulated by PA 1995, 2004 and PSA 1993
* Commonly described as DB or DC
* Main difference is how they are funded and burden of risk between employer and member
* DB – majority of risk bears with employer
* DC – majority of risk bears with the members
* Hybrid – both DB and DC
* In the past, could not be a member of an occupational pension scheme if also contributing to personal pension scheme – this changed as a result of FA 2004.
* Can be a member of multiple schemes
* Annual limit of tax relief on pension savings
* Set up under Trust

(Relevant section of the manual is Part 4 Chapter 1.1)

1. **As a benefit consultant, you have been asked to draft a report outlining and explaining what a Career Average Revalued Earnings pension scheme is and include an example.**

**20 Marks**

Your answer should be in the format of a report and should cover the following:

* Increasing popular alternative to final salary schemes
* Examples are Tesco, Co-operative Group
* Benefits reflect earnings throughout the period of membership
* Final salary just reflects earnings towards the end of membership
* Typical example, 1/80th accrual, 1 April scheme anniversary:

A member joins the scheme on 1 July (three months after the scheme anniversary of 1 April). His Pensionable Salary at the following anniversary is £25,000. At that time, his accrued benefit for the scheme year is calculated as: (9/12) x 1/80 x £25,000 = £234.38 p.a.

Year Two: By the next scheme anniversary, the member has a salary of £26,000. His accrued benefit during his second year of membership is calculated as: 1/80 x £26,000 = £325.00 p.a. At the same time, the benefit accrued during the first year is revalued. For the purposes of this illustration, it is assumed that the Revaluation Rate is equal to the increase in the Retail Prices Index (RPI), which is assumed here to have been 3.5%. This is then added to the most recently accrued benefit to form a ‘running total’. The total accrued benefit at the most recent scheme anniversary is therefore: Year one’s benefit £234.38 x 1.035 £242.58

* Measure of predictability
* More control over costs
* Usually increase with price inflation and not depend on member’s DOL
* Suitable to varying work patterns
* More appropriate as more people tend to move around and have more jobs

(Relevant section of the manual is Part 4 Chapter 2.1.3)

1. **What are stakeholder pensions.**

**10 Marks**

Your answer should cover the following:

* Personal pension scheme that satisfies minimum standards
* Limit on annual management charges
* Accept transfer-ins and no charge made
* Can stipulate a minimum contribution as long as no more than £20
* Default investment option
* From 8 October 2001, every employer with 5 or more employees which did not provide an occupational pension scheme, not contribute 3% to GPP had to designate a stakeholder pension scheme
* Employees did not have to join, and employers did not have to contribute
* Empty shells – aa requirements saw the abolition of the stakeholder requirement
* Existing members must be able to remain in the scheme if they so wish and employer must continue to deduct contributions and remitting them to the provider.

(Relevant section of the manual is Part 4 Chapter1.2.7)

1. **Briefly explain what a cash balance scheme is.**

**5 Marks**

Your answer should include the following:

* DB schemes
* Money purchase characteristics
* Contributions paid in, invested and at retirement provided with a cash sum
* Cash sum used to purchase a pension
* Cash sum defined at the outset and not depend on investment returns
* The employer will make up any shortfall

(Relevant section of the manual is Part 4 Chapter 2.1.5)

1. **Your pensions manager has asked you to prepare a paper explaining what a Defined Benefit Pension is and explain the difference between a final salary pension scheme to a career average revalued earnings scheme.**

**20 Marks**

Your answer should be in the format of a paper and cover the following:

* Occupational pension schemes
* Pension is calculated by formula
* Formula set out in the scheme rules
* 2 types – final salary & CARE
* Members generally contribute at a fixed rate
* Employers’ contribution rate is variable – as have to make up any shortfall
* PSA 2021 – statement from trustees on funding position and investment strategy

Final salary:

* More common type
* Amount on retirement calculated by a formula
* Pension = accrual rate x final pensionable salary x pensionable service
* Accrual rate is a fraction commonly 1/60th or 1/80th
* Final pensionable salary is based on the member’s salary at dol
* Exact definition varies – average over the last 12 or 36 months. In some cases, overtime is allowed, or a deduction is made (LEL)

Career average revalued earnings:

* Benefits reflect earnings throughout the period of membership
* Final salary just reflects earnings towards the end of membership
* Typical example, 1/80th accrual, 1 April scheme anniversary:

A member joins the scheme on 1 July (three months after the scheme anniversary of 1 April). His Pensionable Salary at the following anniversary is £25,000. At that time, his accrued benefit for the scheme year is calculated as: (9/12) x 1/80 x £25,000 = £234.38 p.a.

Year Two: By the next scheme anniversary, the member has a salary of £26,000. His accrued benefit during his second year of membership is calculated as: 1/80 x £26,000 = £325.00 p.a. At the same time, the benefit accrued during the first year is revalued. For the purposes of this illustration, it is assumed that the Revaluation Rate is equal to the increase in the Retail Prices Index (RPI), which is assumed here to have been 3.5%. This is then added to the most recently accrued benefit to form a ‘running total’. The total accrued benefit at the most recent scheme anniversary is therefore: Year one’s benefit £234.38 x 1.035 £242.58

* Measure of predictability
* More control over costs
* Usually increase with price inflation and not depend on member’s DOL
* Suitable to varying work patterns
* More appropriate as more people tend to move around and have more jobs

(Relevant sections of the manual are Part 4 Chapter 2.1.1, 2.1.2 & 2.1.3)

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

**10 Marks**

Your answer should cover the following:

* 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. **The pensions manager is in the process of setting up a new private pension scheme. They have asked you to draft a paper setting out the main considerations that should be discussed in the process.**

**20 Marks**

Your answer should be in the format of a paper and cover the following:

* Considerable freedom over scheme design
* Pensions tax legislation (FA 2004)
* DWP legislation (PAs)
* Other non-pensions UK and EU law – general trust or contract law
* Contributions for members?
* NRA?
* Used to comply with AA requirements?
* If so, is it being set up on the basis requirements or more generous ones?
* Benefits be uniform?
* More flexible options at the decumulation stage? i.e. Flexi-access drawdown?
* Separate categories of membership?
* Executive top-up section?
* Two separate schemes – different one for AA and those who satisfy a specified eligibility criteria?
* Colourbox pensions arrangements is an example of scheme design and how it has changed over the years. Originally opened in 1962, now only open to invitation to senior staff. Structure fairly typical of a final salary but proved to be very expensive. So, Money purchase scheme established in 2004, matched contributions. The Colourboxx Cosmetics Retirement Benefits scheme set up in 1997 and now being run as a closed scheme. Stakeholder arrangement now offered to its employees.

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

1. **Briefly explain what a master trust is.**

**5 Marks**

Your answer should cover the following:

* Multi-employer trust-based pension scheme
* Each participating employer has its own ring-fenced section
* Benefits are usually on a DC basis
* Single professional trustee board responsible for administering the scheme, selecting service providers and a range of investment options.
* Each participating employer determines the eligibility criteria and contribution rates.

(Relevant section of the manual is Part 4 Chapter 2.3.2)