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

**Mock Examination Notes**

**Recommended Time: 2 Hours**

1. **You have been asked to present a training session on the two main types of pension schemes, defined benefit and defined contribution. Prepare a short presentation.**

**25 Marks**

Your answer should be in the format of a short slide deck covering the following:

Defined benefit schemes:

* Always occupational schemes
* Pension calculated by reference to a formula – scheme rules
* 2 common types – final salary & care
* Members contributions are generally at a fixed rate
* Employer’s contribution rate is variable – makes up any shortfall
* PSA 2021 requires a statement from the trustees on the funding and investment strategy
* Final salary – based on the following formula:

Pension = N x Accrual Rate x Final Pensionable Salary

N = length of time the member has been a member of the scheme

Accrual Rate = is a fraction usually 1/80th or 1/60th

Final Pensionable Salary = based on members salary in a period just before leaving service, i.e. average earnings in the final 12 or 36 months of service. Some cases they may make deductions for LEL or disregard overtime.

* Care – popular alternative to final salary

Principal difference is that benefits reflect earnings throughout membership rather than just the period preceding dol

The example arbitrarily uses an accrual rate of 1/80th and a scheme anniversary of 1 April; in practice these – together with the definition of Pensionable Salary and the Revaluation Rate – will be formally defined in the scheme rules. Year One 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 p.a. Year two’s benefit £325.00 £325.00 p.a. Accrued total £567.58 p.a. On each subsequent scheme anniversary, the aggregated running total is revalued and added to the benefit accrued over the course of the most recent scheme year.

Maintaining a measure of predictability and so more control over costs.

Also suitable to employees who have varying earnings patterns due to changes in hours or bonus’ or overtime.

Defined Contribution schemes:

* DC basis are also referred to as money purchase schemes.
* Member’s retirement benefits by reference to level of contributions paid in and investment return.
* Increase / decrease depending on market conditions and not known in advance what the total fund will be at retirement.
* Most of the fund will need to be converted into income at retirement, historically been done by purchasing an annuity. Again, uncertainty as dependant on annuity rates at retirement.
* Contribution rates set in the rules for both members and employers.
* Cost is easily predicted.
* Cost known in advance, but the benefit is unknown.
* Most common solution – lifestyle funds.
* Gradually switch members investments to a mix of assets that matches the type of benefits expected to be paid out.
* New pension flexibilities from April 2015 – gave members more options at retirement.

(Relevant Sections of the manual are Part 4 Chapter 2.1.1, 2.1.2, 2.1.3 & 2.1.4)

1. **Outline what an occupational pension scheme is and how this differs to a personal pension scheme.**

**10 Marks**

Your answer should include the following:

Occupational pension schemes:

* Established by an employer to provide pension benefits and other ancillary benefits to its employees
* Administered in the UK
* Most are regulated by the PA 1995, PA 2004 & PSA 1993.
* Commonly described as DB or DC schemes depending on the benefits they provide.
* Set up under trust with trustees or managers appointed to run the scheme.

Personal pension schemes:

* A pension scheme that is not an occupational pension scheme
* Established by a person with permission under FSMA 2000
* Tends to be provided by insurance companies
* An individual will enter into a contract with the insurer
* Contract will set out the terms upon which the scheme will operate
* Many employers set up a group personal pension plan – essentially a collection of personal pension arrangements.

(Relevant Sections of the manual are Part 4 Chapter 1.1 & 1.2)

1. **Your client is looking to set up a pension scheme for automatic enrolment. Please prepare a paper setting out the main features of automatic enrolment, who would be eligible and what requirements must be satisfied for the scheme to be a ‘qualifying’ scheme.**

**20 Marks**

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

Main features:

* All eligible jobholders must be automatically enrolled into a qualifying scheme.
* They may opt out of the scheme within one month of being auto-enrolled.
* The employer has a duty to automatically reenrol eligible jobholders who have opted out, approximately every three years.
* Employers can postpone their obligation to automatically enrol by up to three months, starting from the date an individual becomes eligible for auto-enrolment. During this period, eligible jobholders do not need to be automatically enrolled but they must be informed of their right to opt in during this period.
* The duties now apply to all new employers from the date on which their first worker begins to be employed.

Eligibility:

* There are three categories of worker in respect of which employers have obligations: eligible jobholder, non-eligible jobholder and entitled worker.
* The definition of worker includes a wide range of individuals (working in the UK), including temporary and agency workers.
* Eligible jobholders are those between age 22 and SPA earning more than an earnings trigger. Generally, eligible jobholders must be automatically enrolled into a qualifying scheme.
* Workers with qualifying earnings (see below) who earn less than the earnings trigger are known as non- eligible jobholders, as are workers with qualifying earnings who are between 16 and 22 or between SPA and 75.
* Non-eligible jobholders do not have to be automatically enrolled into a qualifying scheme, but they have to be informed of their right to membership of such a scheme.
* Workers aged between 16 and 75 who do not have qualifying earnings (i.e. earn less than the lower qualifying earnings threshold) are known as entitled workers.
* Entitled workers must be informed of their right to membership of a scheme, but this need not be a qualifying scheme - the employer is not required to contribute towards the scheme.

Qualifying scheme:

* The employer must auto-enrol employees who satisfy the above earnings and age criteria into a qualifying scheme.
* A qualifying scheme is broadly a HMRC-registered occupational or personal pension scheme that meets certain minimum quality requirements. These minimum requirements differ depending on the type of pension scheme (e.g. whether it is a DC, DB or hybrid scheme).
* For a DC scheme to be treated as a qualifying scheme, statutory minimum levels of contributions must be paid (see 3.2.3 – these are contributions of at least 8% of qualifying earnings, of which at least 3% must be paid by the employer) OR it must meet the alternative quality requirements for DC schemes (see below).
* For a DB scheme to be treated as a qualifying scheme, it must either satisfy a test scheme standard, or it must meet the alternative quality requirements for DB schemes (see below). A test scheme for a scheme providing a pension at retirement is one that gives a pension payable from age 65 (or the member’s SPA if higher) of 1/120 of final qualifying earnings (averaged over the final 3 years of service) for each year of service. However, the test scheme differs for schemes that provide a sum of money to be made available for the provision of benefits.
* It is possible for a CARE scheme to meet the test scheme standard or the alternative requirements, but it must meet additional requirements relating to the revaluation of benefits.

(Relevant Section of the manual is Part 3 Chapter 3.2.1,)

1. **List 10 things schemes must follow under the disclosure requirements.**

**10 Marks**

Your answer should include the following:

* Certain information has to be given to all members on joining, and updated when it changes (generally via the member booklet);
* Members can request formal scheme documentation, and certain actuarial information.
* A trustees’ report must be prepared annually and made available to members on request.
* Information must be given to members when they leave or retire (including for DC benefits a retirement wake-up pack at least 4 months before their expected retirement date), and if the member were to die, to the member’s beneficiaries.
* A ‘summary funding statement’ must be given to all members, normally annually, in respect of any non- money purchase benefits.
* Annual benefit statements must be given to members automatically in respect of any money purchase benefits, but need only be given on request to members in respect of non-money purchase benefits; •
* Those accruing large pension benefits must be provided with annual ‘pension savings statements’ setting out the amounts in the scheme that need to be tested against the member’s annual allowance When benefits are taken, the member must (up to 5 April 2024) be informed how much of his ‘lifetime allowance’ was used up by that ‘benefit crystallisation event’. From 6 April 2024 with the abolition of the lifetime allowance, disclosure requirements instead relate to how much of the lump sum allowances have been used up.
* Information on specific events (such as winding up) needs to be disclosed when they occur.
* Where a member wishes to transfer ‘safeguarded benefits’ (broadly DB or certain money purchase benefits with an underlying guarantee) worth over £30,000 the member must be informed that the trustees or managers are required to check that independent advice has been received before the member is allowed to make a transfer for the purpose of accessing flexible benefits.
* Since 1 June 2022 where a member with flexible benefits (broadly, DC benefits) applies to transfer their pension rights or start receiving benefits, trustees must refer them to Pension Wise.

(Relevant Section of the manual is Part 1 Chapter 2.4.2)

1. **Outline the role of the Pensions Ombudsman.**

**10 Marks**

Your answer should cover the following:

* Investigates and decides complaints and disputes about the way that pension schemes are run.
* Completely independent
* Acts as an impartial adjudicator.
* His decision is final and binding on all the parties to the complaint or dispute.
* It can be enforced in the Courts.
* His decision can only be changed by appealing to the appropriate court on a point of law.
* Deal with complaints of maladministration and disputes of fact or law concerning personal and occupational pension schemes.
* The power to decide these matters rests with the Pensions Ombudsman and Deputy Pensions Ombudsman who are appointed by the Secretary of State for Work and Pensions.
* No charge for using the Pensions Ombudsman’s services. It is funded by grant-in-aid paid by the DWP, which is largely recovered from the general levy on pension schemes
* Since April 2018 the Ombudsman has taken over responsibility for all pension complaints, including those previously dealt with by TPAS
* Require all complainants to have exhausted the scheme’s IDRP before it would consider investigating a complaint under that process.

(Relevant section of the manual is Part 2 Chapter 1.3)

1. **You’re a benefits consultant, you’ve been asked to draft a report on Employer Financed Retirement Benefit Schemes. In your report you should explain what they are and the difference between unfunded EFRBS and Funded EFRBS.**

**20 Marks**

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

Employer Financed Retirement Benefit Schemes (Formerly Unapproved Schemes):

* Before 6 April 2006 there were limits on the maximum benefits that could be paid out from an approved pension scheme, based on an employee’s earnings.
* Employers who wanted to provide more than this, typically for their high earning executives, often did so by way of a top up to an ‘unapproved scheme’. Such schemes which could be funded schemes with an associated trust (Funded Unapproved Retirement Benefit Schemes) or simply contractual promises made by the employer on an unfunded basis (Unfunded Unapproved Retirement Benefit Schemes).
* 6 April 2006, the concept of scheme approval fell away, and both FURBS and UURBS became known as employer-financed retirement benefit schemes – EFRBS.
* Initially, where benefits were paid out in lump sum form, they were free of income tax. Contributions were normally only paid by the employer, and these were taxed on the member as a benefit in kind with the employer claiming immediate relief from corporation tax.
* Investment returns were taxed at a lower rate than other trusts.
* If the scheme was set up offshore, it was not subject to UK tax except on UK source income.

Unfunded EFRBS:

* The employee does not suffer any tax liability on the notional cost of the benefits promised.
* The benefits may be paid as a pension or a lump sum and both will be taxed when they are paid to the employee in the year of receipt.
* Provided that no more than 25% of the value of the benefits is paid in cash form, and certain other requirements are satisfied, no national insurance is payable on the benefits.
* The employer can expect to be able to treat the payments as a business expense for corporation tax purposes.

Funded EFRBS:

* FA04 introduced changes which made funded EFRBS unattractive for benefit accrual or contributions after 6 April 2006.
* From that time, the tax on investment returns was increased to the rate applicable to other trusts. There was no longer a tax charge on employer contributions but instead the benefits paid out were taxed.
* Because of these changes, it was uncommon for contributions to a funded EFRBS to continue after 5 April 2006.
* Typically, other benefits were given instead, such as cash or by higher contributions to a registered scheme (in contrast to the position prior to 6 April 2006, it became possible to provide benefits in a mainstream pension scheme in excess of the tax- privileged limits).

(Relevant Section of the manual is Part 4 Chapter 2.3.6)

1. **List 5 things that make communications more effective.**

**5 Marks**

Your answer should cover the following:

* Be clear about the purpose
* Agree the target audience
* Should be clear, helpful and relevant
* Be timely
* Suitable method of delivery

(Relevant Section of the manual is Part 1 Chapter 2.4.1)