**Core Unit 3 – Running a Workplace Pension Scheme**

**Assignment 2 Notes**

(Part 3 – Benefits and Communication)

Recommended Time: *2 hours 30 minutes*

1. **Outline the key features of Pension Commencement Lump Sums (PCLS) and Trivial Commutation Lump Sums (TCLS).**

**(You are not required to cover GMPs or to go into detail about lifetime allowance calculations and limits in your answer).**

**15 marks**

Answer should cover:

*PCLS (5 marks)*:

* PCLS of 25% of the value of the total benefits being taken from the scheme may be paid, providing scheme rules allow;
* DC scheme - typically be 25% of the value of the member retirement pot;
* DB scheme – more complex due to Lump Sum Allowance implications;
* PCLS is tax-free;
* Must be paid in conjunction with scheme pension, lifetime annuity or drawdown;
* can be paid within 6 months either side of the date of entitlement of the connected pension – out with this period PCLS deemed an unauthorised payment;

*TCLS (10 marks)*:

* may be possible to commute the whole of a members benefit into a one-off lump sum where a member’s total pension benefits are small;
* Prior to 6 April 2015, the TCLS payment could be paid in respect of all of a member’s benefits in the scheme, both DB and DC;
* Introduction of UFPLS for DC schemes from 6 April 2015 means TCLS now paid in respect of DB pension rights or scheme pensions in payment derived from DC pots;
* only available where the value of the individual’s pension rights from all registered schemes does not exceed £30,000, some exceptions;
* Conditions must be met in order to pay a TCLS:
	+ minimum age 55;
	+ all DB benefits from the chosen scheme or schemes are commuted;
	+ member must have some available allowance;
	+ if more than one arrangement is to be commuted, all commutations must take place within a twelvemonth period;
	+ value of all the member’s pension rights cannot exceed £30,000 on the nominated date;
	+ actual amount paid to member determined by the scheme - may be more or less;
	+ member can choose nominated date - if no date is chosen, default nominated date is chosen by the trustees and is taken as the first day of the commutation period;
	+ TCLS must extinguish a member’s entitlement to defined benefits under the scheme;
	+ Payment of any DC benefits is paid as an Uncrystallised Fund Pension Lump Sum.
	+ Any benefit commuted that doesn’t meet all conditions treated as an unauthorised payment.

Relevant section of the manual is Part 3 Chapters 3.7 and 3.8.

1. **At the Annual Renewal of a scheme, what additional information, other than salary, might be included in the annual updating of active members’ records, and what type of reconciliations might be carried out?**

**5 marks**

Answer should cover:

* Additional information:
	+ Contributions paid;
	+ changes in hours and various periods of leave;
* Reconciliations (include 3 of the following):
	+ The sum of the individual contributions equals the amount paid during the year;
	+ The total number of active members agrees with the employer’s records;
	+ All members recorded as being ‘active’ have paid contributions during the year if it is a contributory scheme;
	+ Leaver forms have been received for all leavers.

Relevant section of the manual is Part 3 Chapter 7.5.1.

1. **Explain the requirements and responsibilities relating to the calculation and payment of a transfer out of a registered defined benefits scheme.**

**10 marks**

Answer should cover:

* trustees responsible for determining the transfer value calculation basis;
* trustees must take advice from Scheme Actuary;
* The Occupational Pension Schemes (Transfer Values) Regulations 1996/1847) requires trustees to calculate an ‘initial cash equivalent’. This is the minimum cash equivalent;
* final ‘cash equivalent’ may be either:
	+ initial cash equivalent minus any reduction for underfunding, or
	+ an alternative cash equivalent, provided this is higher;
* initial cash equivalent must be calculated using an ‘actuarial basis’ and must represent ‘the amount

at the guarantee date which is required to make provision within the scheme for a member’s accrued

benefits, options and discretionary benefits;

* Calculation effective date must be within 3 months of member’s request for a statement of cash equivalent;
* effective date is known as the guarantee date;
* written ‘statement of entitlement’ must be issued to member by the guarantee date;
* statement must include a statement of the guaranteed cash equivalent and the guarantee date;
* Where member exercises statutory right to transfer, in writing:
	+ guaranteed cash equivalent must be paid within 6 months of guarantee date;
	+ administrators must keep accurate records of the destinations of transfer payments;
	+ administrators must ensure confirmation received from receiving scheme, certifying that they meet the statutory criteria, to ensure that the trustees receive the statutory discharge.

Relevant section of the manual is Part 3 Chapter 2.6.

1. **Describe why members of defined contribution schemes might explore alternative options to purchasing an annuity at retirement, and outline the alternative options available.**

**20 marks**

Answer should cover:

*Reasons (5 marks)*:

* member does not need security and regular payments provided by annuity and would rather leave pension fund invested;
* current annuity rates don’t provide value for money;
* annuities have become more expensive - due to increased life expectancy and lower investment returns on low risk assets
* annuity purchase may involve locking in pension funds into a product that is fixed earlier on in an individual’s life;
* very difficult for members to be able to determine the right annuity type and right death benefits;
* annuities are fixed meaning it is not possible for income to fluctuate which can cause issues with tax planning in later years.

*Income withdrawal (10 marks)*:

* also referred to as “drawdown” - replaced the previously used terms ‘Unsecured Pensions’ and ‘Alternatively Secured Pensions’ from 6 April 2011 as part of the changes introduced by the Finance Act 2011;
* available from age 55 onwards (exceptions – protected pension age, ill-health retirement);
* individual can leave their pot invested and draw an income directly from it;
* at retirement a member can take up to 25% of their pot, tax-free, as a pension commencement lump sum and designate the remainder to provide flexi-access drawdown;
* drawdown payments treated as income subject to Income Tax at the member’s normal marginal rate;
* amount designated for flexi-access drawdown is tested against individual’s lifetime allowance
* pre 6 April 2015 - income drawdown could be taken as either:
	+ capped drawdown – means of taking variable pension benefits without setting up an annuity;
	+ flexible drawdown – only available to non-active members of a pension scheme;
* flexible drawdown arrangements in place on 6 April 2015 automatically converted to a new flexi-access drawdown arrangements;

*Short Term Annuities & UFPLS (5 marks)*:

* Short term annuities - pay a set income for a period of up to five years, attractive option for members wishing to ease themselves into retirement by a move to part time working, may be used in conjunction with drawdown;
* UFPLS - introduced on 6 April 2015, give DC members opportunity to take their benefits either in one go, or in smaller chunks, can be taken from any uncrystallised funds, first 25% of an UFPLS is tax free, remainder is subject to tax at the member’s marginal rate.

Relevant section of the manual is Part 3 Chapter 3.6.

1. **Briefly explain the key features of Pension Sharing on divorce.**

**5 marks**

Answer should cover:

* introduced by the Welfare Reform and Pensions Act 1999, for divorce proceedings commencing on or after 1 December 2000;
* some or all of a member’s pension can be shared with an ex-spouse;
* more common approach than “Earmarking’” although Earmarking can still be used instead;
* requires the actual transfer of benefits from the member to the ex-spouse resulting in reduced pension benefit for the member;
* reduction in member’s pension known as a pension debit, new pension rights for ex-spouse

known as a pension credit.

* ex-spouse or civil partner may be entitled to use their pension credit to secure a deferred pension in the scheme, depending on the scheme policy on divorce.

Relevant section of the manual is Part 3 Chapter 5.2.

1. **Outline four external services trustees may use in order to delegate their investment related activities.**

**15 marks**

Answer should cover:

*Investment Managers*:

* Trustees usually delegate responsibility for day to day scheme investment decisions to external investment managers;
* Provided investment managers are properly appointed, trustees not responsible for poor investment decisions made;
* appointments must be formally accepted and highly specific;
* Appointments will cover, among other things, the asset class(es) in which investments are permitted, the performance benchmark and agreed attribution, and risk tolerance ;

*Investment Advisers*:

* provide trustees with general guidance on asset allocation and benchmarks, taking into account the nature of the scheme’s liabilities;
* also often report on the performance of investment managers, individually and overall;
* schemes with 100 or more members - trustees must prepare and maintain a statement of investment principles, and they must obtain and consider the advice of an appropriately qualified and experienced investment adviser.
* Many firms of pension consultants and advisers have specialist investment departments who will provide advice on investment allocation and strategy;

*Custodians*:

* organisation engaged to manage part of the scheme’s assets, such as share certificates and property deeds;
* custodian aims to reducing the risk of loss or fraud;
* must either be formally appointed in writing using a custody agreement or they can be a party to the investment management agreement;
* their appointment should be regularly reviewed to ensure that they do not expose the scheme to any significant risk;
* Trustees generally appoint one or more custodians to hold securities and other assets on behalf of the scheme;
* If overseas investments are held, one or more sub-custodians will usually be appointed;
* Trustees may also appoint additional third parties to work with a custodian to provide additional services such as the independent valuation of assets and managing cash and foreign exchange on a day to day basis;

*Investment Monitoring Services*:

* Investment monitoring services usually provided by a merchant bank or other investment specialist;
* Can also monitor performance of insurance contracts and managed sunds operated by insurance companies;
* Comparison made with investment portfolios of other funds;
* Provide regular reports on investment performance.

Relevant section of the manual is Part 3 Chapter 6.1.4.

1. **Describe the revaluation requirements for non-GMP deferred benefits in a defined benefit scheme.**

**10 marks**

Answer should cover:

* Pension Schemes Act 1993 – deferred benefit in excess of GMP must be revalued to NPA;
* Applies to members who left pensionable service from 1 January 1991 onwards;
* Method of revaluation depends on type of scheme and date of leaving scheme;
* Statutory minimum revaluation – for each complete year between DOL and NPA:
	+ Benefits accrued before 6 April 2009 – the lower of the rise in prices and 5% pa compound;
	+ Benefits accrued after 5 April 2009 – the lower of the rise in prices and 2.5% pa compound;
* RPI used until 1 January 2011, thereafter CPI;
* Some schemes provide higher revaluation than the statutory minimum, for example:
	+ allow a 5% cap on post 5 April 2009 benefits;
	+ continue to use RPI after 2011;
* CARE schemes - revaluation requirement under PSA 1993 can be met by either:
	+ Revaluing the deferred benefits (described above), or
	+ Revaluing the salary of the deferred member as would have applied if active service had continued.

Relevant section of the manual is Part 3 Chapter 1.4.4.

1. **Outline the role and responsibilities and requirements of a Scheme Actuary and a Scheme Auditor.**

**10 Marks**

Answer should cover the 5 key points below:

*Actuary (5 marks)*:

* Pensions Act 1995 requires trustees of DB scheme to appoint a named scheme actuary;
* must not be a trustee, administrator or member of the scheme;
* must acknowledge the appointment and confirm they will notify the trustees of any conflict of interest;
* On resignation or removal, a scheme actuary must produce a statement detailing any circumstances connected with the resignation which they believe may significantly affect the interests of scheme members or beneficiaries;
* trustees have 3 months in which to replace a scheme actuary who has resigned, been removed or died;
* Legislation sets out which functions must be carried out by the scheme actuary, for example:
	+ Advice to trustees on funding of scheme, including the valuation of the liabilities of the scheme and advice on the future contributions required to meet the statutory funding objectives;
	+ Advice to trustees on method and assumptions used to calculate cash equivalent transfer values;
* Provision of actuarial certificates;
* advice on early and late retirement factors and cash commutation factors.

*Auditor (5 marks)*:

* Regulations under the Pensions Act 1995 require a scheme’s annual accounts to be audited;
* The primary function of the auditor:
	+ Compile a report stating whether or not the scheme accounts have been prepared in compliance with the regulations
	+ Prepare the auditor’s statement on the contributions payable to the scheme
	+ Provide reasons for any negative or qualified statements in the auditor’s reports
	+ Report material breaches of law of material significance to TPR
* Auditor must meet the requirements of the Companies Act 2006 for a ‘statutory auditor’ or be

specifically approved by the Secretary of State;

* An auditor of a scheme may not also hold a position as a trustee or administrator of that scheme, nor be a member of the scheme.
* A formal letter of appointment must be signed by the trustees and the auditor.

Relevant section of the manual is Part 3 Chapters 6.1.1 and 6.1.2.

1. **Describe the process whereby trustees exercise discretion to pay lump sum death benefits, and outline the types of death benefit that may be payable after a member of a defined benefit scheme has put benefits into payment.**

**10 marks**

Answer should cover:

 *Discretion (5 marks)*:

* Lump sum death benefits paid under trustees’ discretionary do not form part of the deceased’s estate therefore is not assessable for Inheritance Tax;
* scheme rules may restrict the categories of potential recipients the trustees can consider;
* Typical practice:
	+ member nominates one or more beneficiaries by completing a nomination or expression of wish form;
	+ trustees are not obliged to comply with this nomination;
	+ trustees will determine the potential recipient(s) taking account of both the member’s nomination form and also the member’s personal circumstances at death;
	+ trustees usually make their decision as to which of the potential recipient(s) will receive a lump sum death benefit, and in what shares, either at a full trustee meeting or through an appointed committee;
* allowance may need to be made if an earmarking order under a divorce settlement required a specified percentage of any lump sum death benefit is to be paid automatically to the member’s ex-spouse/civil partner.

*Death in Retirement (5 marks)*:

* Death in Retirement before or after NPA typically:
	+ Dependants’ pensions payable to a spouse/civil partner and also possibly to qualifying children;
	+ A lump sum representing the balance of the pension that would have been paid to the member during a ‘guarantee period’ (usually five years from the retirement date);
* Following flexible retirement:
	+ depends on what the scheme rules provide for;
	+ may include both a death in service lump sum and a death after retirement lump sum;
	+ spouse’s/civil partner’s and children’s pensions may also be payable.

Relevant section of the manual is Part 3 Chapters 4.2.2 and 4.1.3 to 4.1.5.