**Defined Contribution Arrangements**

**Assignment 1 Notes**

*(Part 1 – Defined Contribution Scheme and System Design) Recommended Time: 3 hours*

# You act as Secretary to the Trustees of a trust-based DC scheme. A newly elected Member Nominated Trustee (MNT) has contacted you and is keen to learn the various areas of legislation that have impacted the design of DC schemes. Draft a memo responding to the MNT’s query.

**30 marks**

Format: In the style of a memo including to, from, date and subject.

Style: A memo can be less formal than a letter or report.

Answer should cover:

* + Brief introduction
	+ Stakeholder pension arrangements Between October 2001 and October 2012 employers in the main had to designate a stakeholder pension scheme where they did not provide relevant alternative pension arrangements for employees. The removal of this requirement coincided with the introduction of the employer duties under automatic enrollment.
	+ Tax simplification (A-Day) Introduced 6 April 2006. Summarised as follows: one single ax regime for all kinds of pension, no limits on pension savings, Previous limits replaced by AA and LA. Benefits on death and retirement tested against LA and BCE. 55% charge on funds in excess of LA. Earliest age for retirement increased from 50 to 55 with effect from 6 April 2010 except for ill health. Tax-free lumps sum available of up to 25% of retirement fund. Transitional arrangements to protect benefits accrued prior to 6 April 2006.
	+ Taxation of Pension savings…To qualify for tax concessions the scheme must comply with regulations laid down by HMRC. Consequently, the design is influenced by the AA and LA. LA restricts the tax relief that a member can receive on the benefits that they accrue over their lifetime in all registered pension schemes. The AA acts to restrict the tax relief that is available to a member over what is usually a 12-month period. It is £1.073,100 in 2022/23. If benefits paid out are deemed unauthorized this can result in tax charges for both the recipient and the scheme.
	+ Abolition of DC contracting out. Abolished from 6 April 2012 following the Pensions Act 2007. This applies to all schemes including DB schemes which were contacted out on a DC basis. It reduced the administrative burden on schemes. Reduced the costs borne by scheme members. Allowed members greater choice in the investment of funds and in the provision of survivor benefits, made buying an annuity on the open market more viable and simplified the decumulation process.
	+ Automatic enrolment… In the Pensions Act 2008 the Government legislated to require employers to automatically enroll their employees between the ages of 22 and APA in a qualifying scheme and pay in a minimum level of contributions. Started to be phased in from 1 October 2012 ending in February 2018. Any employee has the right to opt out, but they will be r-enrolled later – every three years.
	+ Money purchase definition Defined under section 29 of Pensions Act 2011 which came into force from July 2014. Provides that a benefit is only money purchase where its rate or amount is calculated solely by reference to assets which must necessarily suffice. Although the definition had retrospective effects back to 1 January 1997, the regulations ensured that schemes did not normally have to revisit past actions and decisions. The legislation that sits behind these new rules is complex and trustees and employers should seek legal advice to understand whether, and how, their schemes will be impacted.
	+ TUPE The Transfer of Employment (Pension Protection) Regulations 2005 were amended with effect form 6 April 2014. – the new employer had to offer membership of an OPS or stakeholder pension scheme and either match employee contributions up to 6 % of basic pay match the contributions paid by the transferor employer immediately prior to the transfer if paid onto a money purchase or stakeholder scheme.
	+ DC flexibilities and transfers. From 6 April 2015, additional flexibilities for DC pension savings at retirement were introduced via the Taxation of Pensions Act 2014. They apply to ‘money purchase arrangements’ as defined under the Finance Act 2004 and therefore apply to pure DC schemes or sections of schemes including DC AVCs and cash balance schemes/sections.
	+ Finance Act 2023 The Lifetime Allowance, the maximum amount someone can accrue in a registered pension scheme in a tax efficient manner over tier lifetime will be completely abolished from 6th April 2024. The lifetime allowance charge was removed from 6th April 2023. So there is now no restriction on how much can be accrued.
	+ From 6 April 2024, under the Finance Act 2024,new allowances were introduced which place limits on the total amount of lump sums and lump sum death benefits that individuals can receive free from Income Tax:
	+ Lump Sum Allowance - the maximum amount of benefits an individual can take from all their pension schemes as tax-free cash. The limit is £268,275, but this may be higher if the individual holds a protected allowance.
	+ Lump Sum and Death Benefits Allowance – the maximum amount of benefits an individual and their beneficiaries can take from all the individual’s pension schemes as a tax-free lump sum. The limit is £1,073,100, but this may be higher if the individual holds a protected allowance.

(The relevant section of the Study Manual is Part 1, Chapter 1.3)

# Describe the key features of the Single Tier State Pension and the changes to the State Pension Age introduced by the Pensions Act 2014.

**15 marks**

Answer should cover:

* + Available for those reaching SPA after 6 April 2016. Those reaching SPA before 6 April 2016 were eligible for the previous two-tier State pension.
	+ 35 qualifying years of NICs; those with fewer receive a proportionally reduced amount.
	+ A minimum number of qualifying years is required which will usually be 10 years.
	+ Increased annually by at least the increase in the general level of earnings.
	+ NICs made by the self-employed count in the same way as those paid by employees.
	+ It is not possible to derive or inherit pension from a spouse or civil partner.
	+ It is still possible to defer claiming the State pension in return for a higher weekly amount; however, there is no longer the option for individuals to receive a lump sum deferred payment instead.
	+ Transitional arrangements
	+ Pensions Act 2014 brings forward the increase from 66 to 67 eight years earlier than it was originally timetabled. The increase will be phased-in between 2026 and 2028.
	+ Secretary of State to review whether the rules around the SPA are appropriate, given life expectancy and other relevant factors, and to prepare and publish a report at least every six years on the outcome of the review.
	+ The Government has confirmed its intention to increase SPA from age 67 to 68 between 2037 and 2039 but has not yet brought forward legislation to enact this change.

(The relevant sections of the Study Manual are Part 1, Chapter 1.4.1 and 1.4.2)

# Summarise the main features of Automatic Enrolment.

 **10 marks**

Answer should cover:

Main features of Automatic Enrolment

* + Brief outline of the requirements and when they were introduced. Pensions Act 2008 required employers to automatically enroll their employees been the ages of 22 and SPA into a qualifying scheme and pay in a minimum level of contributions.
	+ Phased employer staging. From 1 October 2012 finishing February 2018.
	+ Opting out and automatic re-enrolment (normally every 3 years)
	+ TPR penalties for non-compliance.
	+ Description of a qualifying DC scheme including Qualifying Earnings.
	+ Certifying money purchase schemes.
	+ Contractual enrolment as an alternative.
	+ The Pensions (Extension of Automatic Enrolment) Act 2023

(The relevant section of the Study Manual is Part 1, Chapter 1.3.5)

# Explain some of the potential drawbacks and benefits of individuals having real-time access to their member records.

**15 marks**

Answer should cover:

Real time access provides online facilities for employees, allowing individuals to view live information and process amendments. These facilities now include online enrolment and the ability to set contribution rates and update fund choices with data files interfaced to payroll and administration systems.

Potential drawbacks:

* + Some schemes felt that it was a risk to allow members to see out of date or incorrect data held on their member records.
	+ Security concerns – hackers, viruses, data protection etc.
	+ Stand-alone system to get round security concerns only one way; members could see their details but could not update their personal records.

Benefits for schemes:

* + Reducing the number of queries from the membership.
	+ Allowing a degree of self-administration, lightening the administration burden of the administrator.
	+ Encouraging members to alert the scheme more frequently to changes to their personal data.
	+ Giving a greater degree of transparency, as members can see exactly what has occurred on their accounts.

 (The relevant section of the Study Manual is Part 1, Chapter 3.5.5)

# You are the Pensions Manager of XYZ Ltd who runs a bundled DC scheme. You have been contacted by a member of the XYZ Ltd Pension Scheme who has asked you to explain the difference between a bundled arrangement and an unbundled arrangement. Write a letter responding to the member’s query.

**20 marks**

Format: In the style of a letter including address, date, correct salutation, and subject heading.

Style: Formal but answering the member’s query in as clear and concise terms as possible.

Answer should cover:

Bundled arrangements:

* + Services provided by a single company.
	+ Combined fee.
	+ Attractive for employers looking to control costs.
	+ Can accept employer and/or employee contributions (regular or single premium) then invested.
	+ Funds managed by the provider or, increasingly, external links offered with access to other investment managers.

Unbundled arrangements:

* + Managed by the trustees, who may choose to outsource.
	+ Tend to be of a size to warrant more control by the trustees.
	+ Scheme trustees can monitor investment performance and make changes to their investment manager.
	+ Advantage is trustees have greater control over choice of providers.
	+ Trustees need to have sufficient governance procedures in place.

(The relevant sections of the Study Manual are Part 1, Chapter 2.8.1 and 2.8.2)

# The chair of trustees for the XYZ scheme has emailed you to ask for information on Straight Through Processing (STP). Set out a response explaining the process and how the adoption of STP could improve the administration process.

**10 marks**

Answer should cover:

* + What is STP. Straight Through Processing. The ability for two computer systems to exchange and process information without human intervention.
	+ How STP compares to manual processes. Prior to STP the interfaces between administrators and investment managers were built around manual processes for exchanging data. However now there is reduced manual intervention in investment transactions, which should lead to a quicker exchange of information providing greater efficiency providing better management information and improving risk control.
	+ Benefits of STP. Considerable benefits in terms of speed, cost savings and reduced risk of error. The creation of an electronic interface between the administration systems and fund manager allows reconciliation of units, trade by trade and eliminates the need for human intervention during the investment process. Less out-of-the market time for members.

(The relevant section of the Study Manual is Part 1, Chapter 3.8)