PMI

Core Unit 1a – Understanding Retirement Provision

STUDY MANUAL

PMI ACADEMY

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Founded in 1976, the PMI is the UK's largest and most recognisable professional body for employee benefit and retirement savings professionals, supporting over 7,000 members.

PMI's members, represented throughout the UK, are responsible for managing and advising some of the largest institutions in the world accounting for £1.3 trillion invested in pensions. We promote excellence through a range of services for the benefit of members, the wider economy and with over six million now saving as a result of automatic enrolment, society as a whole.

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- **Champion professional standards**
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Foreword

Undertaking a rigorous professional qualification places significant demands on a learner and by the introduction of Pathways we are allowing you to decide the direction of your career and identify the qualifications that will best help you reach your goals. Plus, when you join a Pathway, you become a member of the PMI community, proving your expertise in workplace retirement and accessing exclusive resources and networking opportunities.

PMI Pathways was introduced to simplify the route to Fellowship as well as simplify the membership grading structure and for a number of quality opportunities, those being:

Skill Specialisation:
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To complete a Pathway learners will need to complete all units and qualifications within that Pathway and each of our 5 Pathways is meticulously crafted to enhance your expertise, demonstrate your knowledge, and build your professional reputation.

Our Pathways offer five specialised streams: Retirement Provision, Pensions Administration Technical, Pensions Administration Practical, Pensions Trusteeship, and Pensions Benefits.

This manual is for use within the Professionalism and Governance module which sits across every Pathway. It is part of the module all PMI Pathways undertake before they reach Associate Membership (APMI) and provides a synergy and context to delivering communications to the materials learned in the units taken to get to this point.

Further details on the units that comprise each Pathway and the work of the PMI can be found on the website. We hope you will enjoy studying with the PMI and we welcome feedback you would like to offer. This feedback should be directed to the Qualifications Department at PMI: **pmiqualifications@pensions-pmi.org.uk**

Preface

This unit takes you from having little or no specialist pensions knowledge to a position where you will have a good understanding of all the various types of pension provision that there are in the UK.

This unit seeks to cover all aspect of retirement provision and consequently includes State pensions, as well as other State benefits, and also private (non-State) pensions, both employer sponsored (workplace) and individual pensions. We also consider the interaction of State pensions with non-State pensions.

We start off looking at the origins of retirement provision which provides the background and context of current arrangements. These include the needs of the employee and the various options available, as well as some alternatives to pensions. It is impossible to understand the way that pension schemes are set up without knowledge of the past and current taxation regimes that have influenced their design.

In the next Part of the manual we then consider the parties involved in retirement provision. This includes relevant Government departments and those who help to deliver pensions.

Part 3 outlines the various State pensions and other relevant benefits. This Part includes an outline of Automatic Enrolment and NEST.

Part 4 explores in detail workplace pension arrangements. This includes the legal structure of occupational schemes and explains why they are set up as they are. This introduces the concept of trusts and trustees, and how they operate in the field of pensions. We look at the different benefit structures commonly found in these arrangements and examine the defined benefit (including final salary) and defined contribution (money purchase) concepts. The other major plank of non-State pension provision is the personal pension. Although younger than its occupational cousin, having been introduced in its current form in 1988, it continues to increase in importance. The Part looks in detail at all types of personal pensions, including Group Personal Pensions and Self Invested Personal Pensions (SIPPs).

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Syllabus

Aim:

To provide an introductory overview of retirement provision in the UK including an appreciation of:

- how workplace pensions have developed, the different types of workplace provision and how they sit alongside State pension provision
- the key features of automatic enrolment, trust and contract-based provision
- the roles and responsibilities of those involved in running workplace pensions
- personal savings and the options for retirement saving
- employee engagement with retirement provision.

Impact of July 2024 general election

Please note that this manual was last updated on the basis of pre-election policy so certain provisions may change following the general election on 4 July 2024; and references to 'government' policy apply to the Conservative government in place prior to the election. Now that the Labour Party has been elected, there will be new priorities and it is likely that various timescales will be pushed back, particularly for anticipated government consultations, and that some policies and initiatives will be abandoned or reviewed. We have noted the most obvious areas of uncertainty within the relevant sections.

1. Demonstrate an understanding of the origins and overview of retirement provision. Explain the following aspects:

- State
- workplace
- individual

2. Demonstrate an understanding of the context and the factors which influence the development of retirement provision in the UK.

- identify changes to State pension age, State benefits, historic and forthcoming legislation
- explain the options available to access pension saving
- define demographics
- outline changing social trends
- describe balancing work, retirement and income
- explain different income needs in retirement and options

3. Describe the main State retirement benefits and other benefits an individual might receive from the State and explain how retirement benefits are calculated. Analyse the features of:

- the new State Pension
- Basic State pension
- State Second Pension (S2P)
- Pensions Credit

Outline the features of other State benefits

4. Describe the role of the key parties involved in retirement operation of a workplace pension scheme, their interaction and any conflicts of interest. Analyse and distinguish between the roles of the following:

- Government departments
- regulatory bodies
- advisers (including consultants, legal advisers, investment advisers, scheme actuary and auditors)
- members and their dependants
- employers/pensions manager, payroll and human resources
- secretary to the trustees
- service providers, including administrators
- investment managers
- insurer

5. **Identify the roles and functions of the bodies that regulate pension schemes and provide assistance or protection to members and employers. Outline the role and powers of:**

- The Pensions Regulator (TPR)
- Department for Work and Pensions (DWP)
- HM Revenue & Customs (HMRC)
- Pensions Ombudsman
- Financial Ombudsman Service
- PPF Ombudsman
- The Money and Pensions Service (including The Pensions Advisory Service (TPAS), The Money Advice Service (MAS) and Pension Wise)
- Citizens Advice Service
- Pension Protection Fund (PPF)
- Financial Conduct Authority (FCA)
- Financial Assistance Scheme (FAS)
- Financial Services Compensation Scheme (FSCS)
- National Insurance Services to the Pensions Industry (NISPI)
- The Information Commissioner
- The Pension Tracing Service
- Fraud Compensation Fund
- Pension Schemes Registry

6. **Explain the main features of the employer duties for automatic enrolment and re-enrolment describe automatic enrolment, contractual enrolment and re-enrolment. Define jobholders and workers.**

- identify:
  - qualifying earnings and pay reference periods
  - qualifying schemes and automatic enrolment schemes
- explain phasing in and staging
- describe the communication requirements and timescales
- explain the role of the Pensions Regulator

7. Distinguish between the different methods of providing and delivering pensions and the different benefits and options

- identify the essential features, legal structure, delivery model and characteristics of workplace pension schemes
- evaluate occupational pension schemes, personal pensions, stakeholders and SIPPs
- identify universal automatic enrolment schemes including master trusts and their roles
- explain the roles of the employer, trustees, providers, and employer and provider governance committees

8. Demonstrate an understanding of the different types of benefit design found in pension schemes. Describe the main benefit design features:

- defined benefit (final salary and career average)
- defined contribution
- cash balance
- hybrid arrangements
- risk sharing schemes

9. Understand the context and the main types, and principal features, of workplace pension schemes found in both the private and public sectors, and explain the difference between insured and self-administered schemes.

- define public sector benefit structure
- describe:
  - private sector benefit structures
  - master trusts
  - cross border schemes
- identify the features of:
  - insured schemes
  - self-administered schemes
  - executive pension arrangements and employer financed retirement benefit schemes

10. Demonstrate an understanding of the financing of pension schemes. Analyse the financing of workplace pension schemes:

- defined benefit
- defined contribution
- defined ambition/risk sharing
- pay as you go

11. Evaluate what an employer might consider when selecting a trust, master trust or contract-based arrangement.

- identify the advantages and disadvantages of each

12. Evaluate the options for personal savings. Explain the features of the following:

- personal investments
- alternative investments
- insurances

13. Describe the options available for retirement saving. Outline the features of:

- tax advantaged savings vehicles
- property
- pension arrangements

14. Understand the main features of employee communications with saving for retirement. Outline:

- statutory disclosure requirements
- the concepts of advice and guidance

Part 1

PROVIDING FOR RETIREMENT

OVERVIEW

This Part introduces the issues surrounding retirement provision. It provides the overall context for the Parts that follow, which explore in more detail pension provision in the UK.

There are two Chapters. In Chapter 1 you will learn the historical context of retirement provision. Chapter 2 covers the needs of the employee when saving for retirement, the options available and, finally, the important issue of employee engagement.

When you have completed this Part, you will understand the context and issues surrounding retirement provision and pension saving, and the importance of employee engagement.

CHAPTER 1

Introduction to the Origins and Overview of Retirement Provision

INTRODUCTION

In a village or tribal community, the whole community supported those who, for whatever reason, could no longer contribute to the wealth of the group. This arrangement represented a direct transfer of support from those who could work to those who could not. No reserves would be built up to provide the benefit. Instead, the amount of benefit would be balanced between the willingness and ability of those who could work to provide it, and the needs of the recipients. This is a form of collectivism.

Instead of relying on the community to provide, people could try to make provision for themselves by saving money during their working lifetimes. This could then be spent in later life. It might have been gold coins in a jar, or even money under the mattress, but it was a basic form of funding. This is a form of individualism. Its effectiveness depended on the amount of money saved and what this would buy when the person's working life was finished.

The origins of present-day pension arrangements can be found in the emerging collectivism of medieval times. If an individual fell on hard times through illness, disability or old age, the only help was from the Church, the ruling Lord's Manor or the local boroughs.

As Guilds developed, they also played an important part in helping individuals in need. Guilds were religious or charitable organisations, which developed into the trade associations of merchants and craftsmen that still exist today. These charities were usually only able to help in the event of sickness, disability and in the provision of pensions for widows and orphans.

The State only became involved in the Elizabethan era when the welfare of the poor became a national concern. Legislation was passed through the Poor Laws of 1597 and 1601, which made the local boroughs responsible for providing for the poor within their areas.

During the Victorian era the widely accepted ethos was of self-help and society did not feel that the State needed to provide pensions to the general population. Neither was it expected of the employers of the time, although some did provide pensions for their workers. So, generally, it was left to the workers to group together and provide for themselves in times of financial hardship. These groups later became the first friendly societies, although short life expectancy and the extended family meant that the main benefits the societies paid out were death benefits, sickness and disability pensions, rather than pensions after retirement.

1.1 SEVENTEENTH CENTURY PENSIONS

Some seventeenth century employers started to offer ex gratia pensions to chosen employees as a reward for long service. These were usually on an unfunded basis, with the amounts being subject to the whim of the employer and the ability of the workforce to provide sufficient profits to enable the employer to pay. The whole system was open to abuse by the employer since the employee had nothing more than an expectation that the benefit would continue.

On an individual basis, it was common practice for an employee taking over a role to continue to pay a proportion of his current salary to his predecessor, until that person died. Samuel Pepys is a well-known example. This was a direct transfer of funds from one generation to another. It worked well for the better off employees, but created a heavy burden for lower paid employees who needed all their earnings to live.

1.2 THE FIRST OCCUPATIONAL PENSION SCHEME

The first occupational pension scheme was set up for the benefit of Customs and Excise Officers. It operated on a 'pay as you go' unfunded system, which meant that the contributions collected from the employer and the employees were paid out almost immediately in pension benefits to other retired members. This scheme set the precedent for the initial design of all occupational pension arrangements. Throughout the eighteenth century it was gradually extended and altered to include other civil servants.

The Civil Service Pension Scheme was historically the model for HMRC (HM Revenue & Customs) approval, and even today the level of benefits offered in defined benefit (DB) occupational schemes are strongly influenced by it.

The Pensions Act 2004 and the Finance Act 2004 introduced sweeping reforms to the pensions system. More recently the Pensions Act 2008 introduced the concept of automatic enrolment. For more information on these reforms, see 1.7 below.

1.3 NINETEENTH CENTURY PENSIONS

Even though employers began to introduce occupational schemes for some of their senior employees, few employers offered occupational pensions to all their workers until the mid to late nineteenth century when the industrial revolution was really underway.

One of the first was the Gas Light and Coke Company, shortly followed by the independent railway companies.

Operating from the nineteenth century, the Civil Service pension scheme was notable in offering a model that, as we will see, was to form the basis of 'New Code' approval (See 1.4.2 below) and consequently become widely adopted by companies in the private sector nearly a century later: a pension for life of one sixtieth of final pay for each year of service up a maximum of 2/3rds of final pay.

1.4 THE MAIN FINANCE ACTS

1.4.1 The Foundations: Finance Acts 1916 and 1921

The principal piece of early legislation governing insured schemes (other than those written under trust) is the 1916 Finance Act which granted tax relief on premiums in connection with all 'bona fide pension schemes'.

The 1921 Finance Act formed the basis for the legislative structure that has governed occupational pension schemes for most of the last 100 years. It established the principle upon which pensions tax relief still generally operates, i.e. the EET principle:

- contributions are Exempt from tax
- investments built up are largely Exempt from tax
- pensions are payable subject to Tax

To be eligible for this tax treatment, the scheme had to be established under trust; and its sole purpose had to be the provision of annuities for former employees on their retirement.

The requirement to provide annuities, later extended to other forms of regular income, reflected a concern that had been expressed many years earlier by the Radley Commission on the Civil Service, which in 1888 objected to the payment of a lump sum on the ground that "in the event of providence or misfortune in the use of it, [the retired member] may be reduced to circumstances which might lead to him being an applicant for public or private charity."

1.4.2 The 'New Code': Finance Act 1970

Subsequent legislation introduced further changes, including limits on contributions and on the amount of pension that could be commuted for a lump sum; and the introduction of retirement annuities, principally for the self-employed.

In the late 1960s, with over half the workforce being members of occupational pensions, the pension system was in need of rationalisation and consolidation. The result was the Finance Act 1970 (and the Income and Corporation Taxes Act 1970, a consolidating Act) which introduced the 'new code' under which occupational schemes needed to be approved by the Inland Revenue (forerunner to HM Revenue & Customs (HMRC)). Retirement annuities for the self-employed continued, under the provisions of s226 Income and Corporation Taxes Act 1970 (later s620 ICTA 1988).

New Code approval allowed a maximum pension of 2/3rds of final pay, part of which could be commuted for a lump sum of up to 1.5 times final pay (using a commutation factor of 9:1, which was commonly used for males aged 65, this would equate to commuting a maximum of 25% of the pension for cash).

There was no limit to the amount that could be paid out from a retirement annuity ('s226 contract'), which was constituted on a money purchase basis. However contributions were limited. This limit was expressed as a percentage of remuneration that depended on the individual's age. Part of the benefit could be taken in the form of a lump sum.

1.4.3 Simplification: Finance Act 2004

The Finance Act 2004 introduced the current pensions tax regime. The new rules, which were intended to consolidate and simplify the tax legislation relating to pensions, came into effect on 6 April 2006 (commonly referred to as A-Day). Under this regime, which replaced the previous 'discretionary approval' by the Inland Revenue, employers and members are able to benefit from the tax advantages associated with pension schemes provided the scheme is registered with HMRC, and makes payments that are authorised under the 2004 Act.

Despite all the changes to the tax legislation governing pension schemes, the underlying principles reflected in the 2004 Act were broadly unchanged from those underpinning the 1916 and 1921 Acts: subject to certain limits, tax relief would be available on contributions made to bona fide pension schemes, being pension schemes set up with the main purpose of providing an income in retirement which would then be taxed. (Apart from changes of detail, arguably the one change of principle introduced by the 2004 Act was a recognition of an emerging need for flexible retirement towards the end of the working life,

in allowing pension to be drawn while continuing to work, perhaps on a part-time basis - thus taking an income from the scheme before technically being 'in retirement'.)

1.4.4 Pension freedom and choice

Under the Finance Act 2004 (as modified by FA05) one of the ways in which defined contribution (DC) schemes were able to provide an income in retirement was through capped income drawdown. This allowed the member to take varying amounts each year (in contrast to the regular instalments received from a pension or annuity). Under capped drawdown, the maximum amount of income that could be taken in any year was limited by regulations designed to ensure that the member did not run down funds too quickly. However, there was no minimum amount that must be taken (any funds that were not drawn remaining invested to benefit the member in later years).

The Finance Act 2011 introduced further freedom in the choices available to certain members through the concept of flexible drawdown. This allowed an individual who was no longer an active member of any scheme and satisfied the minimum income requirement (MIR) to take uncapped flexible drawdown. This meant that there was no limit to the drawdown amount that they could take in any year, which would be taxed as pension income in the normal way.

A core idea behind the MIR was that there should be no danger of someone who depleted their fund quickly falling back on State benefits. To qualify, the person must have a secure pension income above the threshold amount of the MIR. The MIR could include State pensions, scheme pensions and lifetime annuities, as well as some other State benefits and overseas pensions. Income drawdown is specifically excluded. Initially the MIR was set at £20,000p.a..

For some individuals, therefore, Finance Act 2011 changed a fundamental principle that had underpinned tax- privileged pension provision for a century - that pension funds should be used to provide an income for life (with the exception of the limited amount allowable as a tax-free lump sum). However, arguably this change was not that radical, as it only affected the small minority of members who were able to satisfy the MIR.

Further changes were introduced on 6 April 2015 that radically changed the way in which money purchase benefits could be taken, providing individuals with greater choice about what to do with their funds on retirement. These allow members of money purchase arrangements, once they have reached normal minimum pension age (usually 55), to flexibly access their savings how and when they want, subject to their pension scheme rules. The money purchase flexibilities apply to cash balance arrangements and money purchase additional voluntary contributions (AVCs) within defined benefit schemes as well as pure money purchase funds.

The new measures were implemented very quickly – the announcement was made in Budget 2014 (without a prior consultation period) and the necessary changes to the tax legislation were contained in the Taxation of Pensions Act 2014. The combination of the radical nature of the change and its very short lead in period required a period of intense activity by government departments and regulators, the pensions industry and those managing or sponsoring pension schemes in order to ensure that the new measures were implemented as intended and without consumer detriment.

The changes also led to rules on guidance and advice to be provided for those seeking to take benefits or transfer into money purchase arrangements. This is covered within 1.19.6 below.

In July 2020 the Work and Pensions Committee (WPC) launched a three-part inquiry into the impact of the pension freedoms and the protection of pension savers:

- Part one looked at pension scams and what more can be done to prevent them. The WPC called on the Government to act quickly and decisively to combat scams and warned that the commonly cited figures underestimate the scale of the problem. A key recommendation is for tighter online regulation; the Government has said that it will review the regulatory framework of paid-for online advertising.
- Part two considered accessing pension savings, looking at how savers are prepared and protected to move from saving for retirement to using their pension savings. The WPC concluded that although the 2015 freedoms have on balance been a success, many savers need more support than they currently receive. As a response, In July 2023, following several consultations on helping savers understand their pension choices, the government confirmed that "when parliamentary time allows" it would introduce legislation requiring trust-based occupational DC schemes to offer a decumulation framework to support members when they take their pension.
- Part three looked at saving for later life and what more needs to be done to help people plan and save for retirement. The WPC's report noted that over 60% of people are at risk of missing out on an adequate standard of living in retirement, despite the introduction of automatic enrolment. It warned that minimum contributions to pensions are too low and that many self-employed and gig economy workers are being excluded completely from pension saving. In response the Government said that it remained committed to implementing the 2017 automatic enrolment review reforms (see Chapter 3).

1.5 STATE BENEFITS

In the UK many current pensioners rely almost wholly on the State for the benefits they receive in retirement, with a minority receiving significantly more than State benefits. This is expected to change in the future as employee membership of occupational and personal pension schemes grows following the introduction of automatic enrolment (see 1.7.2). However, it is expected to take many years before most those being enrolled into a pension scheme for the first time will have built up sufficient funds to generate a significant income in retirement.

For those who reached SPA before April 2016, there are two State schemes in operation: the Basic State Pension (BSP), sometimes called the old age pension, and the State Second Pension (S2P). S2P replaced the State Earnings Related Pension Scheme (SERPS) with effect from April 2002.

For those reaching SPA from April 2016, State retirement provision is from one 'flat-rate' State Pension, referred to here as the new State Pension.

Most State pension arrangements, including the UK's, are funded on a pay as you go basis. This means that assets do not build up during a working lifetime, but the contributions of today's workers are immediately used to pay the benefits to today's pensioners.

This can be viewed as a contract between generations. However, problems can arise if a population 'ages', due to factors such as increasing longevity. In this case, unless there is an increase in the birth rate or in net immigration (on the basis that immigrants are on average younger than the population as a whole), the number of contributors compared with recipients declines. If this is not to result in an increasing burden on the younger generation, either the level of state pension has to reduce or it must be paid for a shorter period (by delaying the start date).

State benefits may take the form of a universal flat rate benefit, an earnings-related benefit or, as has historically been the case in the UK, a combination of the two (although this has been replaced by a single tier flat rate system for those reaching SPA from 2016).

In the UK, pensioners on low incomes and with modest savings have also been able to receive extra payments from the State through a means-tested benefit (called the Pension Credit, formerly the Minimum Income Guarantee), which brings their total benefit up to a prescribed level. However the new State Pension has been set at a level that will mean that eligibility for Pension Credit will decline and it is expected to eventually become unnecessary.

1.6 RETIREMENT PROVISION FROM PENSIONS

The National Employment Savings Trust (NEST) published results from research it carried out in 2014 stating that 76% of the population had some form of pension savings and this was expected to increase further following the introduction of automatic enrolment in 2012. This was borne out by DWP statistics: **Workplace pension participation and savings trends 2009 to 2022**, issued in November 2023, notes that in 2022 88% of eligible employees (20.4 million) were participating in a workplace pension.

Valuable tax reliefs are offered to employees and the self-employed to encourage them to make provision for themselves through group or individual schemes. Employees who choose not to join, or are not eligible for an employer sponsored arrangement, as well as the self-employed, can have an individual arrangement instead. Within certain limits, employees may have both an employer sponsored arrangement and an individual one.

1.6.1 Employer Sponsored Benefits

Employer sponsored schemes are established either as a trust, by an Act of Parliament or on a contract basis. In the past, most members of such schemes could expect to receive pay-related benefits, called final salary benefits or defined benefits, where the benefit is expressed as a proportion of pay close to retirement (or date of leaving if earlier) for each year of service. However, an increasing number of members will receive benefits on a money purchase or defined contribution basis where the benefit is the product of the contributions paid in, the investment returns achieved while those contributions are invested. To the extent that the benefit is provided in the form of an annuity, the amount will depend on the price of annuities at the time of purchase.

1.6.2 Public Sector Pension Schemes

Public sector schemes are divided between statutory schemes and non-statutory schemes. Statutory schemes have their provisions contained in either a statute, a statutory order or an instrument made under a statute. The non-statutory schemes are mainly those of the nationalised industries and are usually established by a Trust Deed and Rules in a similar way to employer sponsored private sector schemes.

A relatively small number of public sector schemes cover millions of employees whereas in the private sector smaller groups of employees are covered by thousands of schemes. The public sector includes public corporations such as the Bank of England and the Civil Aviation Authority and nationalised industries such as coal mining and railways.

1.6.3 Personal/Individual Benefits

Most individual plans are on a money purchase/ defined contribution basis. Individuals who belong to an employer`s scheme can also pay additional voluntary contributions (AVCs) or take out other pension arrangements or a personal freestanding additional voluntary contribution arrangement (FSAVC). FSAVCs are insured arrangements that are usually unconnected with any particular pension scheme and which individuals can use to increase their retirement provision, subject to limits on the total contributions payable. They came into existence at a time when there were restrictions on members of occupational schemes being concurrently contributing members of Personal Pensions. These restrictions no longer apply and many FSAVC contracts have since been converted into personal pensions.

1.6.4 Stakeholder Pensions

Stakeholder arrangements provide benefits on a money purchase basis. They have to meet certain requirements including flexible contract terms and a cap on charges. Between October 2001 and October 2012 every employer with five or more employees had to provide access to such a scheme unless they offered an employer sponsored arrangement which all qualifying employees could choose to join. However, there has never been any requirement for the employer to contribute to it, nor for employees to join it. As a result, the stakeholder regime did not encourage pension saving to the degree that successive Governments considered desirable and has largely been overtaken by the automatic enrolment regime which started coming into effect from 1 October 2012. The requirement to 'designate' a stakeholder pension scheme ceased to apply with effect from 1 October 2012.

1.7 THE CURRENT PENSION SCENE

The main Acts steering state and private pensions are set out below (some of this legislation is built on by subsequent Acts).

1.7.1 The Pensions Act 2007

The Pensions Act 2007 legislated for reforms to the State pension system in the light of demographic changes.

Among other things, it set a schedule for increasing state pension ages, provided for the basic state pension to increase by reference to average earnings and eased the qualifying criteria – these provisions are covered later. The Act also created the Personal Accounts Delivery Authority (PADA) to advise on the introduction of a new, simple, low-cost pensions savings vehicle, originally named Personal Accounts but subsequently rebranded as the National Employment Savings Trust (NEST). The purpose was to extend the benefits of workplace schemes to those currently without access to them by establishing a simple, low-cost pension scheme available for all employers whether or not they have suitable alternative pension arrangements.

1.7.2 The Pensions Act 2008

The Pensions Act 2008 introduced measures aimed at encouraging greater private saving. This included a duty on employers to automatically enrol all eligible workers into a qualifying workplace pension scheme (provided they are not already in such a scheme). Most of the measures in the Act came into effect from 2012. The Act broadened the remit of PADA giving it powers to enable it to establish NEST. (PADA was wound up in July 2010 and its main functions transferred to NEST).

1.8 PERSONAL SAVINGS

This source of retirement provision can take many forms. The most common of these are savings accounts, insurance policies, Individual Savings Accounts (ISAs) (which in 1999/2000 replaced PEPs (personal equity plans) and TESSAs (Tax Exempt Special Savings Arrangements)), unit trusts and investment trusts and the proceeds of the sale of houses or businesses. These are covered in more detail in Chapter 2.

Summary

We began this Chapter with an outline of the origins and development of retirement provision and pensions through the nineteenth and twentieth centuries. As well as occupational pension schemes this included an overview of State pensions and public sector pensions. Finally, it included a summary of the current retirement provision options and more recent developments relating to money purchase benefits, sometimes known as pension flexibilities or pension freedoms.

Self Test Questions

- What is the EET Principle?
- What changes were introduced with the Finance Act 1970
- What is Drawdown?
- How are State pensions funded?

CHAPTER 2

The Needs of the Employee when Saving for Retirement, the Options Available and Employee Engagement

The question of how to support individuals financially after they can no longer work, has always been an issue. Solutions tend to be found in a number of ways including using up savings; depending on family or on the community; and/or relying on the State. The balance between these solutions differs between societies and it also changes over time, driven by political, social and economic factors.

In 2019, the Pensions & Lifetime Savings Association (PLSA) launched its Retirement Living Standards, designed to help members understand how much money they will need to live the lifestyle they would like in retirement. The standards provide benchmark levels of annual income to fund three different standards of living - minimum, moderate and comfortable - which aim to provide a rule of thumb guide based on common costs for many people. They were last updated in February 2024 to take into account changing pensioner priorities and the increased cost of living. Roughly speaking, the PLSA explains that a single person living outside of London will need (in 2023 terms) about £14,400 a year to achieve the minimum living standard, £31,300 a year for moderate, and £43,100 a year for comfortable. For couples, the figures are roughly £22,400, £43,100 and £59,000. There are separate, slightly higher, figures for London. The PLSA's ambition is for the standards to become widely adopted across the industry (with organisations using them in the communications and tools they provide for their savers).

2.1 THE NEEDS OF THE EMPLOYEE WHEN SAVING FOR RETIREMENT

2.1.1 Obstacles to Saving

Around the turn of the millennium there was a growing concern that people were not saving enough for their retirement, the problems being particularly acute for lower paid workers. There are a number of factors that have contributed to successive generations not making sufficient savings.

Voluntary savings have been affected, in varying degrees, by the following

- The rise in the welfare state, which largely removed the threat of absolute poverty.
- Affordability – cost of living has an impact. The need for food, clothes, rent/mortgage, transport, loan repayments, bills and child-related costs all decrease the amount of disposable income that can be used for savings/pensions.
- Behaviour – individuals tend to prioritise their immediate needs before thinking longer term e.g. an annual holiday or a new car can often be an attractive reason to use disposable income/ savings.
- Culture – Arguably a persistence of the 'spend now, pay later' culture which developed in the credit boom years of the 1980s, contrasting with more of a savings culture of past generations.

To make matters worse, at the same time as these factors were working to depress pension saving, it was becoming clear that economic and demographic factors were far less favourable than had been believed, and were forecast to get worse:

1. Longevity was forecast to rise significantly, resulting in longer expected periods of retirement that would somehow need to be financed; and
2. It appeared that long term investment returns were unlikely to be as high as had been believed previously.

As a result of these concerns, in 2002 the Government set up the Pensions Commission which in 2005 reported its findings. These included the fact that most people do not make rational decisions about long-term savings without encouragement and advice. But the cost of advice in itself significantly reduces the return on saving, particularly for low earners.

The Commission went on to report that the behavioural barriers to savings and the costs of provision have been made worse by the 'bewildering complexity' of the UK State and private pension system, which has caused confusion and mistrust. Furthermore, it found that means- testing within the State system both increased complexity and reduced the incentives to save via pensions.

More recently, the COVID-19 pandemic put more financial pressure on the economy and individuals.

The Money and Pensions Service (MaPS) has been tasked with coordinating a national strategy to improve the country's financial wellbeing, after research by the Organisation for Economic Co-operation and Development (OECD) found that the UK is well down the rankings of G20 countries in terms of financial wellbeing. In 2020 it launched a 10-year strategy setting out five goals to work on over the next decade:

- Financial foundations: increasing the number of children and young people who get a meaningful financial education
- Nation of savers: encouraging regular saving
- Credit counts: reducing the number of people often using credit to pay for food or bills
- Better debt advice: helping more people get the debt advice they need
- Future focus: ensuring people understand enough to plan for and during retirement

The strategy will also examine factors that can make people particularly susceptible to financial detriment, such as mental health conditions and gender.

The gender pensions gap

In June 2023 the DWP published figures estimating that the gender pensions gap in private pensions across Great Britain is 35% (32% for those eligible for automatic enrolment). It is significantly higher (60%) for those who rely on defined contribution (DC) savings only. The analysis also sets out the gender pensions gaps for different age bands, which show a similar pattern to the gender pay gap. It is smallest for those aged 35-39 (10%), increasing to 47% for those aged 45-49 and decreasing again for those in the later years of working life.

The gender pensions gap broadly describes inequality between male and female retirement income, but there is currently no official measure. For the purposes of this report, the DWP defines it as the difference between female and male "non-zero, median, uncrystallised private pension wealth" held by those around normal minimum pension age (NMPA, currently 55). The analysis excludes individuals with no undrawn private pensions – so does not allow for pensioners who have commenced all their private benefits, or for individuals who have no private pensions.

2.1.2 High Level Solutions

Individuals can often face difficult decisions when it comes to saving for retirement – should they spend now or save for a rainy day? The cost of living in retirement continues to rise and the need to save becomes even more important because of it. So, what are the solutions? This is a key question for governments. There are various views on what the optimal solution may be, but we set out below some of the potential solutions.

- Moving away from unfunded State provision and favouring a privately funded alternative. This is one of the more controversial suggestions.
- Encouraging people to save more.
- Encouraging more people to save. The thought process is simple: if it is possible to encourage/enable people who are currently not saving to save a little, this would reduce reliance on the State and would also help enhance people's standard of living. The Government is actively trying to encourage more people to save by the introduction of automatic enrolment (which is covered in depth elsewhere in this manual).

1.1.3 Improving the consumer pensions journey

In 2021 TPR and the FCA launched a joint call for input on the pensions consumer journey. The regulators asked how they can help consumers to make more informed decisions at each stage of their journey, with a view to improving pension outcomes. This is intended to compliment wider work by the FCA to help make the consumer investment market work well for investors and to protect vulnerable consumers, and follows the launch in 2021 of TPR's 15-year corporate strategy, which reflects the shift from DB to DC pension saving.

The regulators identified five main stages to the journey: starting up a pension, accumulating pension savings, approaching retirement, accessing a pension, and decumulating the savings. They are focusing on the first two stages - because the decisions made here fundamentally affect the choices available to savers at later stages of the journey.

In June 2022 the regulators issued a feedback statement covering some future initiatives. The government subsequently carried out a number of consultations on helping savers understand their pension choices. The government noted that, as part of this, it was also considering themes from the responses to the call for input.

2.1.4 Partial and late retirement

Partial retirement

Partial retirement enables a pension scheme member to reduce the number of hours they work by drawing on their pension while remaining in employment. This enables an individual to continue to earn a salary for a longer period, while easing their way into retirement by gradually reducing their hours.

Late retirement

Many schemes already allow members to retire after they reach their scheme's Normal Retirement Date.

The default retirement age of 65 (i.e. an employee's contracted retirement age) was abolished from 1 October 2011. This means that employers are not able to automatically retire employees simply because they have reached their 65th birthday. Employees can choose to retire from age 65 if they wish but it is no longer compulsory, unless an employer can justify such a decision. Such justification might be, for example, on the grounds of the capability of a particular employee. Alternatively, the Courts have found in favour of companies retaining a compulsory retirement age in circumstances where doing so was judged to be a proportionate means of achieving legitimate aims.

With the increase in the SPA (see 2.2.3), it is expected that more people will work beyond their Normal Retirement Date (which is not impacted by the removal of the default retirement age). Some may choose to defer retirement even later and call upon the Scheme's late retirement provisions, whereby an individual can increase their scheme pension by starting it later.

2.2 DEVELOPMENTS IN STATE PENSION PROVISION

Unlike occupational pensions and personal pensions, State pensions are not pre-funded. Instead they are financed on a pay as you go basis. Broadly speaking this means that the amount needed to pay pensioners in any year is taken from the tax and National Insurance contributions paid in that year.

This means that the system is very susceptible to demographic changes, in particular the age dependency ratio (the ratio of individuals who are retired to those who are economically active). Factors such as increasing longevity and falling birth rates have put unfunded State pension provision in the UK, and in Western Europe generally, under increasing strain.

In response to Lord Turner's 2005 Pensions Commission report, in 2006 the Government published a White Paper Security in retirement: towards a new pensions system, which announced its intention to reform the way in which State retirement benefits are provided. As a result the Pensions Act 2007 included the following changes in relation to State pensions:

- Changes to eligibility for the Basic State Pension from 6 April 2010 – see Part 3
- Linking BSP increases to earnings – see below
- Moving the State Second Pension (S2P) towards a flat rate – see below.

The new State Pension is dealt with in Part 3. Note that although the new State Pension has now replaced the BSP and State Second Pension for those reaching SPA from April 2016, the two previous types of State pension are still relevant since they will continue to be paid to those who reached SPA before April 2016.2

2.2.1 Basic State Pension (BSP) Increases

The Pensions Act 2007 provided that the BSP would be increased in line with average earnings. In fact, from April 2011 government policy has been that annual increases to the BSP are usually made in line with the triple lock, being the greater of National Average Earnings, price inflation and 2.5% p.a.. This triple lock is not, however, written into legislation and has been the subject of some political debate (see State benefits in Part 3).

2.2.2 State Second Pension (S2P)

The Pensions Act 2007 provided for the accrual rate of S2P to reduce in two stages, the intention being that it would be converted over time to a flat-rate top-up to the BSP, the change being expected to be completed by around 2030. In the event, however, it was subsequently decided to replace S2P altogether – see the new State Pension in Part 3).

2.2.3 State Pension Age (SPA)

Prior to April 2010, State Pension Age (SPA) was 65 for males and 60 for females.

The Pensions Act 1995 provided for SPA for women to gradually increase so that by 2018 it was aligned for men and women at 65. Under the Pensions Act 2011 SPA increased from 65 to 66 between 2018 and 2020. Current legislation then provides for the unisex SPA to gradually rise to 68 by 2046:

- from 66 to 67 between 2026 and 2028 (Pensions Act 2014);
- From 67 to 68 between 2044 and 2046 (Pensions Act 2007).

The Pensions Act 2014 provides for periodic government reviews of future increases to take place at least once every six years. The reviews will seek to give individuals affected by changes to their SPA at least ten years' notice. The reviews will be based around the idea that people should spend a certain proportion (intended to be broadly a third) of their life after age 20 drawing the State Pension. The government must commission two independent reports: one from the Government Actuary on longevity; and another on other factors relevant to setting SPA (such as healthy life expectancy and differences in life expectancy between socio-economic groups) led by a person independent of government.

The first such independent report, issued by John Cridland CBE, was completed in March 2017. It recommended a timetable for increasing SPA from 67 to 68 between 2037 and 2039, seven years earlier than the current legislation. The rise from 66 to 67 remains as in legislation. In its July 2017 report on its first periodic review, the government confirmed its intention to follow that recommendation; however, in order to allow for future changes in life expectancy projections a further review was needed before legislation could be amended, and this change would need the approval of Parliament.

A second periodic review, launched in 2021, concluded that no change would be made at this time in relation to the rise from 67 to 68, and the Conservative government noted that a further review would take place within two years of its next Parliament to reconsider the rise. It is not yet known how this will be taken forward following the July 2024 general election – the Labour party stated that there was no justification for further increases to SPA.

There has been some concern regarding the effectiveness of the communication of the increases in SPA. This is considered to have particularly affected women, many of whom were unaware even of the equalisation of the SPA legislated for in 1995. A report by the Work and Pensions Committee published in March 2016 concluded that successive governments' attempts to communicate the SPA changes had been too little too late for many women. The cohort of women born in the 1950s were felt to be particularly affected, with some (born before March 1950) retaining a NRA of 60 while others (born after August 1954) are seeing their SPA pushed back to age 66 and are not able to draw their State pension until 2020 at the earliest. In October 2019, the High Court gave judgment on a claim for judicial review brought by the Backto60 campaign; the group challenged the government's handling of the increase in female SPA from age 60. The court dismissed the claims of discrimination, stating that there was no direct discrimination on grounds of sex because the legislation does not treat women less favourably than men; rather it equalises a historic asymmetry between men and women and thereby corrects historic direct discrimination against men. An appeal to the Court of Appeal was dismissed on all grounds in September 2020 and the Supreme Court refused to hear the case.

Separately the Parliamentary and Health Service Ombudsman (PHSO) has been investigating the way the DWP communicated changes to women's SPA.

In March 2024, the PHSO published a report on the findings, which was laid before Parliament, with a request that it looks at the findings and intervenes to agree a remedy for the women affected. Following the July 2024 general election this is for the new government to take forward.

2.2.4 The new State Pension

The Pensions Act 2014 introduced a universal flat-rate pension set above the threshold for most means tested benefits. The new State Pension applies to those who reach SPA on or after 6 April 2016. The level of the new pension is set in regulations each year but in 2024/25 is £ 221.20 per week. The legislation provides that it will be increased in line with earnings, although the current intention is that the triple lock currently applying to the BSP (see 2.2.1) will also apply to the new State Pension.

For further details see Part 3 on State pensions.

2.3 PERSONAL SAVINGS AND OPTIONS FOR RETIREMENT SAVING

Pensions are just one form of providing an income for individuals at retirement. There are many other saving vehicles which individuals can take advantage of to help boost their retirement income. In the following sections we provide an outline of three available options.

2.3.1 Individual Savings Accounts: ISAs, NISAs and LISAs

ISAs / NISAs

Individual Savings Accounts (ISAs) were introduced in April 1999 and are tax-privileged savings vehicles. A saver using an ISA is exempt from paying tax on the income received within their ISA.

There are four types of ISA:

- Cash ISAs
- Stocks and Shares ISAs
- Innovative Finance ISAs
- Lifetime ISAs

Up to 5 April 2024 it was possible to save in one of each kind of ISA during a single tax year. From 6 April 2024 legislation gives more flexibility to split ISA savings (within the total limit) between more than one ISAs within each kind (other than for the Lifetime ISA).

In March 2024 the Conservative government launched a consultation on a further type of ISA – the UK ISA, giving an additional £5,000 allowance for people to invest in UK companies. It is not clear whether this will be taken forward after the July 2024 general election.

Originally, there were two limits that applied to ISAs: one limit applied to the maximum that could be invested in a cash ISA, and higher limit applied to the maximum that could be invested overall, i.e. to a cash ISA and Stocks & Shares ISA combined.

On 1 July 2014 the New ISA (NISA) was launched (although the term ISA is still commonly used, including by the government and HMRC). It was intended to be a simpler product, but there remained two types (cash and stocks & shares). The 2014/15 limits both increased to £15,000 from 1 July, with an overall limit of £15,000. From this date, therefore, the cash ISA is not subject to a separate lower limit, the total annual subscription limit can be allocated between a Cash and a Stocks and Shares ISA as decided by the individual. The limit increased to £15,240 for 2015/16 and 2016/17; and from 2017/18 it increased to £20,000, although this includes any amount paid to a Lifetime ISA (see below).

In April 2016 the Innovative Finance ISA (IFISA) was introduced, making peer-to-peer loans (loans given to other people or businesses without using a bank) qualifying investments for the first time. The stated policy objective was to increase the choice and flexibility available to ISA investors, encourage the growth of peer-to- peer lending and improve competition in the banking sector by diversifying the available sources of finance. In order to offer the Innovative Finance ISA, providers need to apply for regulatory permissions from the FCA.

Irrespective of the type of ISA, contributions are paid out of taxed income but no further taxation (e.g. on investment or when withdrawing funds) is applied. This differs from the tax treatment of pensions where contributions are paid before tax and tax is paid once the pension is in payment (20% for basic-rate taxpayers and 40% or 45% for higher-rate or additional-rate taxpayers).

One of the key advantages of saving in an ISA has been that money can be taken out at any time subject to specified notice periods, whereas a pension is a longer-term investment (even taking into account the introduction of more flexibility in terms of accessing pension fund monies). This provides savers with additional flexibility. This can, of course, be an advantage when saving for a rainy day. However, having easy access to savings can sometimes be a disadvantage when saving for the longer term.

Help to Buy ISA

The Help to Buy ISA was announced in Budget 2015 but in the event proved short-lived. The scheme opened on 1 December 2015 to help those who are saving to buy their first home (valued up to £450,000 in London and up to £250,000 outside London). Savings into this ISA (maximum of £200 per month plus £1,000 in the month of opening) would receive a 25% bonus when the house purchase is completed (so it cannot be used for an initial deposit), up to a maximum of £3,000 on £12,000 of savings. Funds can be withdrawn from the account, but the bonus will not then be made available only for home purchase.

The Help to Buy ISA was only available to new savers until 30 November 2019; but it is open to contributions until 2029. Any bonus must be claimed by December 2030. During 2017/18 it was possible to transfer funds in a Help to Buy ISA into a Lifetime ISA (see below) without using up the £4,000 LISA annual allowance. Any transfers after that date count toward the £4,000 limit.

LISAs

The Lifetime ISA (LISA) was introduced in April 2017 and sits alongside the current pension tax regime.

It provides an alternative means of saving for those under 40, allowing individuals to use their funds to provide a deposit for a first home or to save for retirement. Any adult between the ages of 18 and 40 can open a LISA and contribute up to £4,000 each tax year (post- tax) until they reach 50. Contributions are eligible for a 25% government bonus paid shortly after the contribution, and savings can be withdrawn at any time, but may be subject to a charge.

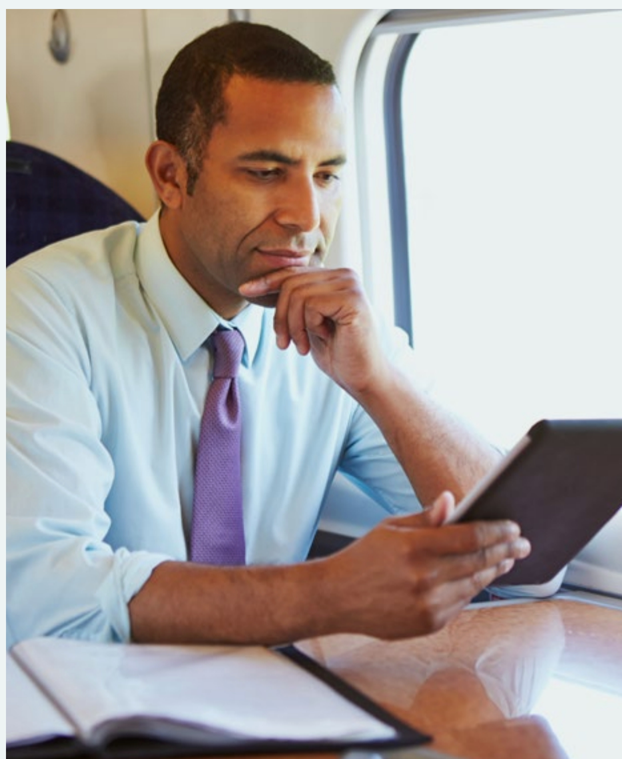
The main features are as follows:

- It is only possible to pay into one LISA in each tax year;
- Any contributions sit within the overall £20,000 ISA contribution limit;
- Individuals can transfer savings from other ISAs as a way of funding their Lifetime ISA. The transferred savings count towards the £4,000 threshold but do not affect the £20,000 limit.

Funds can be used to buy a home (valued up to £450,000) at any time from 12 months after opening the account, or they can be withdrawn from age 60 without a withdrawal charge. If an individual is buying their first home with someone else, they can each use a LISA (but the £450,000 cap remains). Where an individual is terminally ill and has less than 12 months to live, they can withdraw all the funds without a withdrawal charge, regardless of their age. On death, the funds can be drawn without a withdrawal charge and will form part of the estate for inheritance tax purposes.

Funds can be withdrawn at any other time, but a withdrawal charge would be applied to the funds withdrawn (including the bonus element of the fund plus any interest or growth on it). To see the effect of the charge on early withdrawal (other than to buy a house or when terminally ill etc.), consider an individual who contributes £4,000 and then withdraws it shortly after it has received its 25% bonus. The fund plus bonus will be £4,000 + £1,000 = £5,000 (ignore any fund growth). A 25% charge is then deducted, i.e. £5,000 x 0.25 = £1,250. The residual fund is therefore £5,000 - £1,250 = £3,750. So the effective penalty is £4,000 – £3,750 = £250, or 6.25% of the original £4,000.

The government said that it would explore whether there should be the flexibility to borrow funds against the LISA without incurring a charge if the borrowed funds are fully repaid. However, this facility is not currently available.



The LISA can be sold without advice although FCA rules require providers to disclose information on the LISA along with appropriate risk warnings. In particular, individuals must be warned that they may lose out on their employer's pension contributions and that the LISA could potentially affect their right to claim means-tested benefits.

2.3.2 Corporate Wraps

The concept of introducing a corporate wrap (also known as workplace savings or corporate platforms) has attracted some interest. A typical arrangement might allow employees to contribute through their payroll into a choice of ISAs, pensions and investment accounts. It allows the employee to manage workplace and personal financial benefits in one place. Its aims are quite simple:

- To encourage employees to take an active interest in their medium and long term financial affairs;
- To enable employees to become more financially educated; and
- To encourage better outcomes at retirement.

Some of the financial advantages of this vehicle include:

- Employees can maximise their tax breaks by investing in a number of savings options.
- Flexibility – DC employer pension contributions can be invested in an ISA, which is beneficial for an employee wanting to save for a deposit or a high earner affected by pension tax restrictions.
- Money can be transferred e.g. maturing shares can be rolled into an ISA.

However, the vehicle is complex to create and it is extremely important that the level of financial education is right, the communication is concise and clear, and that employees have sufficient tools to enable them to make appropriate decisions.

2.3.4 Property

Property (or real estate), as part of an investment portfolio can help provide diversification. It is a physical asset that enables investors to spread their risk by investing in an asset class that is a growth asset, which in the long term would be expected to be immune to inflation and which should not mirror short term volatility expected of assets such as equities or and gilts. This section provides a brief outline of how property can be used by an individual to provide income in retirement.

Buy to Let

Buy to Let is a form of investment where you buy (or invest in) a property to rent out. When you buy such a property, you become a landlord, which means you have a legal responsibility to your tenant(s). A textbook analysis suggests that as an investment strategy (as opposed to a professional occupation), Buy to Let should normally only be one part of a more diversified strategy.

This kind of property investment does have its attractions to the retail investor. For example:

- It is a real asset, where there is a limited supply and increasing demand;
- It provides a known (pre-agreed) income;
- It has a real-world appeal for non-sophisticated investors because it is a familiar and visible asset;
- There is a commonly held view that property is a good investment or that house prices always seem to increase; and
- In a property boom, stories explaining how some investors have done well are widely circulated and sound attractive.

However there are disadvantages, including:

- A focus on short term capital gains instead of long term yields, and (in times when finance is readily available) becoming heavily geared can leave you dangerously exposed to downturns in the property market;
- Individual investments can go wrong due to lack of expertise or bad luck;
- Unintended costs e.g. repairs;
- The risk of extended rental voids, before replacement tenants can be found and
- The asset can be difficult to sell or exchange, which can lead to a loss in value.
- Governments have increasingly imposed additional taxes on Buy to Let investments such as a 3% stamp duty surcharge, and gradual reduction of mortgage interest tax relief. The erosion of Capital Gains Tax allowances has also increased costs for those selling their rental properties.
- The recent increase in mortgage rates is raising the buying costs of the properties.

The activity of landlords buying residential property in areas such as London and other property hotspots around the UK has been blamed for contributing to the chronic problems around the availability of affordable housing.

The argument is that in recent years a big driver for landlords has been the prospect of capital gain rather than rental income; this has helped drive up property prices to levels well beyond those that are justified by rental yield, and in so doing has resulted in property prices in many areas of the country being out of reach for first time buyers. For the investor there is therefore a political risk of

taxation or other measures being introduced in order to discourage speculative investing in housing stock which would then negatively impact the value of their investment.

Principal Private Residence

An individual can use their main home as a means of providing further income. For example:

- ***Downsizing***
  A simple approach, where you decide to sell your home on retirement, and buy a cheaper property (smaller or in an area which is less expensive) so releasing capital to help fund retirement.
- ***Equity Release***
  Equity release is a term that refers to the various ways that (usually older) homeowners can use their homes to generate a lump sum or regular income, either with a loan secured on their home or by selling all, or part, of their property but continuing to live in it during their lifetime.

Using a Principal Private Residence in this way shares some of the downsides of a Buy to Let, but it does have the advantage that any increase in the value of the property isn't subject to Capital Gains Tax. It is arguably also a half-way house between spending for immediate consumption and investing for the future, since the individual gets immediate enjoyment of the property (although renting of a room is an option).

In either case, there is a danger of overestimating the capital that can be released from the property and underestimating the cost of retirement provision. In some cases, the notion of 'my house is my pension' is one that has not been fully thought through, and is sometimes being used to rationalise a behavioural choice not to save.

Self-Invested Personal Pensions (SIPPs)

SIPPs, which are referred to elsewhere in the manual, can be used to invest in commercial property (but not directly in residential property - although exposure can be obtained via a Real Estate Investment Trust (REIT)). This vehicle enables individuals to provide for their retirement by using a pension fund and investing in property.

2.4 ENGAGING EMPLOYEES WITH SAVING FOR RETIREMENT

Being able to save for retirement, either through a pension scheme or equivalent vehicle, is an important part of an employee's benefits package, which has the potential to be highly valued by an individual. It is therefore important to ensure effective member communication as an aid to ensuring an employee's engagement.

2.4.1 Effective Communication

The art of creating an effective piece of communication is all about getting the right message, to the right person, at the right time. The Pensions Regulator has released guidance on producing effective member communications to help pension schemes to support members and help them get the best out of their pension provision.

It is widely agreed that members who have a lack of understanding of their pension arrangements may make ill- informed decisions or take no action at all. This is particularly significant for members of DC schemes where many of the important decisions relating to member benefits are taken by the members themselves, including: the amount to contribute, what to invest in (which can change over time), when to take benefits and in what form.

Key points relating to effective communications include:

- Be clear about the purpose of communications materials – this helps with providing focus on key messages;
- Agree the target audience e.g. differentiate, where appropriate, between DB and DC members or active, deferred and pensioner members;
- Communications should be clear, helpful and relevant;
- They should also be timely;
- Agree a suitable method of delivery e.g. paper, electronic, face-to-face; and
- Communications should provide members with the information they need throughout their membership of the scheme.

The introduction from April 2015 of the new pension flexibilities for money purchase benefits (see 1.4.4) has arguably made effective member communication even more important: members with money purchase benefits have more options, including that of drawing out their entire pension pots in one go.

This introduces risks for the member such as: misjudging the pace at which the retirement fund can be safely spent, and depleting it too quickly; paying excessive tax (for example by drawing down amounts that put him in a higher rate tax band for that year than he would normally be in); or becoming victim to investment 'scams'.

Partly to address this, the April 2015 flexibilities have resulted in significant new disclosure requirements. These relate to 'flexible benefits' (broadly money purchase or cash balance benefits), and also to defined benefits when the member wishes to transfer his benefit entitlement.

2.4.2 Disclosure Requirements

From 6 April 2014 most of the disclosure requirements relating to pension schemes are contained in the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 ("the disclosure regulations"). Details to be disclosed differ depending on the type of benefits provided.

In relation to occupational pension schemes, the basic structure of the disclosure requirements is as follows:

- 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, see 1.4.2 below.

Similar provisions apply to personal pensions.

In addition, certain other disclosure requirements that apply in certain circumstances – such as divorce, transferring out or a scheme winding up - are contained in separate regulations that relate to those specific circumstances. These rules are in addition to any provisions in schemes' trust documents (and override if the two are in conflict).

Information provided should be accompanied by a statement that further information is available on request, and giving the address (both postal and email) to which enquiries should be sent. Note also that "members" includes pension credit members, as well as active, deferred and pensioner members.

When a member is provided with the means to access flexible benefits (for example when the member is given an application form, online access or certain other information), they must be provided with prescribed retirement risk warnings. The rules for these warnings differ depending on whether the benefits are being taken from a contract-based arrangement, such as a personal pension, governed by FCA rules, or from an occupational pension scheme, regulated by the Pensions Regulator.

These risk warnings address the attributes and features of the choices available that have the potential to adversely affect retirement income, and factors that have the potential to affect the appropriateness of options (such as health status and lifestyle choices, and whether the member has dependants, is in debt or in receipt of means-tested benefits).

Under the regulations most disclosure requirements may be satisfied by electronic means (i.e. by email or on a website) subject to the conditions outlined below. However there are some specific areas, which are governed by regulations that do not explicitly refer to electronic communication.

The Department for Work and Pensions' (DWP) view (expressed in its consultation document from 2013) is that a disclosure requirement "in writing" would include email but not other forms of e-communication such as a website.

The conditions for information to be sent electronically include that:

- if at 1 December 2010 the recipient had been receiving the information in paper form, they must be given the choice of continuing to receive information in that form; and
- where information is made available on a website, members must be informed of the fact and given all the relevant access details. The information must be presented in such a way that it is capable of being stored and printed by the member.

Disclosure by this method is voluntary but there could be cost savings available from adopting electronic communication – in particular, the costs associated with printing, packaging and postage.

From the first scheme year ending on or after 6 April 2018, schemes providing money purchase benefits (unless these are solely AVCs) are required to make certain information from the scheme's most recent chair's statement publicly available free of charge on a publicly available website. From 1 October 2019, the scheme's latest Statement of Investment Principles (SIP), where it is required to have one, must be published on the website and from 1 October 2020, an implementation statement setting out how the trustees have acted on their SIP must also be published online. Members must be made aware that this information is available, via their annual benefit statements.

From 1 October 2022, trustees of auto-enrolment schemes under which all benefits are money purchase must provide their members with 'simpler annual benefit statements' that fit on one double-sided sheet of A4 paper. The changes are aimed at simplifying benefit statements to make them more consistent and easier to compare, following earlier consultation on how to improve member engagement. A cross- industry 'Pension Attention' campaign, led by the Pensions and Lifetime Savings Association and the

Association of British Insurers, ran in autumn/winter 2022 (and is planned to be repeated), to try to boost the nation's understanding of and engagement with their pensions.

2.4.3 Different Communication Methods

Selecting the most appropriate method of communication is linked to how well a scheme or an employer understands their audience. Traditional paper-based communications are still widely used in the following forms:

• Letters • Statements • Forms • Booklets / Guides • Leaflets • Newsletters • Factsheets • Reports

Electronic communications are also widely used e.g. emails, websites, intranet sites, SMS messaging, pod casts and automatic data transfers. However, some members still prefer face-to-face communications via group presentations, meetings or one-to-ones, or by phone.

Whichever methods are used to communicate with members it is vital that the information contained within the communication is consistent.

2.4.4 Style and Communication Guidance

Various industry guides are intended to help trustees communicate with members, giving good practice suggestions, including:

- The DWP's Automatic enrolment and pensions language guide (last updated in April 2014). This sets out seven key principles underlying effective member communication and gives recommendations on the use of both auto-enrolment terms and general pensions terms.
- The Regulator's Communicating and reporting guide, one of six guides that accompanied its code of practice no. 13 on schemes providing DC benefits – which now forms part of the Regulator's general code of practice (see 1.1.2).
- The FCA's discussion paper Smarter consumer communications.
- The European Insurance and Occupational Pensions Authority (EIOPA) 2016 report on Good practices on communication tools and channels for communicating to occupational pension scheme members.
- The Association of British Insurers' Making retirement choices clear, a guide to simplifying pensions language and communicating retirement options effectively.
- The Pensions Management Institute's (PMI) glossary of Pensions Terminology, covering a wide range of pensions terms.

2.4.5 Giving Financial Advice

In relation to pensions, an individual or company must be authorised by a regulator if they wish to:

- Give advice on; or
- Arrange transactions of (for example, making arrangements with a view to assisting another person to complete a deal); or
- Deal in (for example, buying or selling investments); or
- Manage (for example, managing the assets of another person) certain products, including the following:
- Insurance policies such as group pension contracts, personal pension plans, section 32 buy outs and Freestanding Additional Voluntary Contributions (FSAVCs), and other long-term assurance products with an investment element;
- Additional Voluntary Contributions (AVCs);
- Investment options in pension schemes;
- Group life assurance policies (and some individual policies);
- Group permanent health insurance or income protection policies (and some individual policies).

Authorisation is not required in order to advise on, arrange or provide non-financial products and or services (for example, third party administration). Authorisation is also not required to invest one's own money. Where trustees and others want to give advice or guidance to members, establishing whether authorisation is required can be complicated. In May 2006, the Financial Services Authority (FSA) (the FCA predecessor body) issued some formal 'perimeter guidance' setting out the circumstances in which authorisation is or is not required.

In September 2017, the FCA and the Pensions Regulator jointly published a factsheet on what help employers and trustees can provide on financial matters without stepping over the boundary into financial advice and hence being subject to formal regulation.

More recently, the FCA and HM Treasury have been undertaking a joint Advice Guidance Boundary Review that aims to close the gap between financial advice and other forms of support. As part of this, the FCA and HM Treasury consulted until February 2024 on proposals to improve access to financial advice and support.

2.4.6 Financial Advice Market Review

The Financial Advice Market Review (FAMR) was launched in 2015 by the FCA and HM Treasury to identify ways to make the UK's financial advice market work better. It considered access to, and the affordability of, advice in relation to pensions. In March 2016, it published its final report, setting out a series of recommendations, which were accepted by the Government and the FCA.

In December 2020 the FCA published an evaluation of its work on the financial advice market, assessing the impact of the FAMR and the Retail Distribution Review (RDR). The FCA found evidence that the advice market is improving, albeit slowly. However, it also found that many consumers are holding their money in cash rather than investing it and that many do not seek, or receive, the sort of help with their finances that would equip them to make better investment decisions. The FCA is due to provide a further update in due course. Several initiatives have followed from FAMR:

Consultations on provision of public financial guidance

In response to the FAMR, the government announced that the Money Advice Service, the Pensions Advisory Service and Pension Wise would be replaced by a single public financial guidance body responsible for delivering debt advice, money and pensions guidance to the public. The Financial Guidance and Claims

Act 2018 established this single financial guidance body (SFGB) in October 2019, as well as setting out its objectives and functions. From 6 April 2019 the SFGB was named the Money and Pensions Service (MaPS); it is responsible for delivering debt advice, money and pensions guidance to the public (see Part 2).

Pension advice allowance

A pension advice allowance was introduced in April 2017, enabling providers/schemes to allow their money purchase members to take £500 tax free to redeem against the cost of regulated financial advice. The allowance:

- applies to payments made on or after 6 April 2017;
- allows individuals to withdraw up to £500 from their pension pots, no more than once in a tax year and on up to three occasions (so allowing an individual to withdraw up to £1,500 in their lifetime);
- can only be taken from money purchase arrangements (this allows, for example, its use by members of DB schemes with money purchase AVCs);
- must be used for 'retirement financial advice' (i.e. advice in respect of the person's financial position, including their pension arrangements and the use of their pension funds), that is fully regulated financial advice;
- requires the payment to be paid directly from the scheme to the adviser; and
- is operated using a self-declaration system, under which individuals must declare that the advice is regulated financial advice and they have not used the allowance more than twice and not in the tax year of the request. Providers, trustees and advisers expected to operate with basic due diligence - e.g. not executing a withdrawal where the allowance has already been used three times under the scheme).

The allowance is not available for guidance services (as opposed to regulated advice), and it is not mandatory for providers or schemes to offer the facility.

Pensions advice exemption

The Government also introduced a new tax exemption from 6 April 2017 for 'relevant pensions advice'. This exempts from income tax and NI the first £500 worth of pensions advice provided to a current, former or prospective employee in a tax year. For this purpose pensions advice includes information

or advice in connection with the individual's pension arrangements, or in connection with the use of the pension funds. The exemption is conditional on advice being available to all of the employer's employees, or all at a particular location, but it may be restricted to those who are within 5 years of Normal Minimum Pension Age (or of their protected pension age, if applicable) or who are retiring on the grounds of ill-health.

Amending the definition of financial advice

FAMR found a strong consensus for a clearer boundary between guidance and regulated advice and in March 2017 regulations were made that amended the definition of regulated advice. With effect from 3 January 2018, regulated firms are treated as only giving financial advice where they provide a personal recommendation. However the wider definition of advice regarding advising on investments (in the Financial Services and Markets Act 2000 (Regulated Activities) Order) remains in place for unregulated firms.

2.4.7 Pensions Dashboards

In Budget 2016 the Government tasked the pensions industry with ensuring that by 2019 it had designed, funded and launched a pensions dashboard service. The idea is that this will help improve member engagement and make it easier to plan for retirement.

An initial prototype project was managed by the ABI, which concluded that it is possible to build the infrastructure to connect multiple pension schemes to dashboards and for people to see their pensions in one place. Then, in April 2019, following consultation, the government confirmed that a non-commercial dashboard will be hosted by the Money and Pensions Service (see Part 2), with other commercial dashboards to appear over time once appropriate consumer protections are in place. MaPS set up the Pensions Dashboards Programme (PDP) to design and implement the infrastructure that will make pensions dashboards work.

The Pension Schemes Act 2021 provides a legal framework for dashboards, including new powers to compel occupational pension schemes to provide information. This framework will be supported by regulations, guidance, and standards.

Department for Work and Pensions (DWP) regulations set out the detailed requirements to be met by trustees of relevant occupational pension schemes.

The first schemes were due to start connecting by August 2023; however, this was delayed as more time was needed for implementation. Amending regulations specify a single final connection deadline of 31 October 2026, with earlier recommended connection dates for individual schemes being set out in DWP guidance that was published in March 2024. The first such recommended deadline date is 30 April 2025, for the very largest DC mastertrusts and personal pension schemes. The FCA has introduced equivalent rules for FCA-regulated providers that will apply for personal and stakeholder pensions.

The date that dashboards will go live to the public (Dashboards Available Point) has not been announced yet but could be earlier than 31 October 2026.

The Pensions Regulator will be responsible for enforcing compliance with the regulations. It has published guidance on pensions dashboards and encouraged trustees to take action to prepare.

Summary

We began this Chapter summarising the need for saving that included the obstacles to saving and some high-level solutions to the issues. We included descriptions of the different options for retirement saving including ISAs, corporate wraps and property. Finally, we outlined the main points of effective communication and also the statutory requirements as well as the different methods of communication to engage employees with retirement saving.

Self Test Questions

- What are some of the obstacles to retirement saving?
- What are the main types of ISAs?
- How can property be used for retirement saving?
- What is the key to effective communication?
- List some of the different methods of communicating pensions information

Part 2

PARTIES INVOLVED

OVERVIEW

This Part provides an overview and introduction to the key parties involved in retirement provision.

When you have completed this Part, you will know the various parties involved in retirement provision and understand their roles.

CHAPTER 1

The Role of Key Parties Involved in Retirement Provision

INTRODUCTION

A number of different parties may be involved in retirement provision, including:

- The Pensions Regulator (TPR);
- The Financial Conduct Authority (FCA);
- The Pensions Ombudsman;
- The Money and Pensions Service (MaPS - including the Pensions Advisory Service, the Money Advice Service and Pension Wise);
- Citizens Advice Service;
- The Financial Ombudsman;
- The Pension Protection Fund (PPF);
- The Financial Assistance Scheme;
- The Financial Services Compensation Scheme;
- Government departments (HMRC, DWP and HM Treasury);
- The trustees and secretary to the trustees;
- Investment Governance Committees (IGCs);
- employers/pensions manager, payroll and HR;
- members and their dependants;
- advisers to those running the scheme (including legal adviser; investment adviser; scheme actuary and auditor);
- those giving advice or general information and guidance to members;
- service providers including administrators;
- investment managers; and
- insurers.

1.1 THE PENSIONS REGULATOR

The Pensions Regulator (TPR) is the UK regulator of workplace pension schemes. A workplace pension scheme is any scheme that an employer makes available to employees. This includes all occupational schemes and any stakeholder and personal pension schemes where employees have direct payment arrangements. The Financial Conduct Authority (FCA) has a similar role in relation to contract-based schemes (see 1.2).

TPR currently has the following statutory objectives:

- to protect the benefits of members of workplace pension schemes;
- to promote good administration of workplace pension schemes;
- to reduce the risk of situations arising that may lead to claims for compensation from the Pension Protection Fund (PPF);
- to maximise compliance with the employer duties relating to automatic enrolment (introduced by Pensions Act 2008); and
- to minimise any adverse impact on the sustainable growth of an employer (in relation to defined benefit (DB) funding functions only).

In order to meet these objectives, TPR concentrates resources on schemes where it identifies the greatest risk to the security of members' benefits. Where possible, it will provide support and advice to trustees, administrators, employers and others where potential problems are identified.

TPR also has a role in respect of the governance and administration of public service pension schemes (introduced by the Public Service Pensions Act 2013). Since 1 April 2015, it has set standards of practice in order to help the Local Government, NHS, Teachers, Civil Service, Armed Forces, Police, Firefighters and Judicial pension schemes to meet governance and administration requirements set out in legislation.

Also, from 1 October 2018, TPR is responsible for the authorisation and supervision of master trusts (see Part 4).

TPR is also responsible for enforcing compliance with the Pensions Dashboards legislation for trust-based occupational schemes (see 2.4.7).

The Pensions Act 2004 provides TPR with a range of powers to enable it to meet its objectives. Its stated intention is to use these powers flexibly, reasonably and appropriately, with the aim of putting things right and keeping schemes on the right track for the long term. From 1 October 2021, to prevent and penalise mismanagement of pension schemes, the Pension Schemes Act 2021 introduced two new criminal offences and gave new powers for the Pensions Regulator to help safeguard pension schemes.

1.1.1 The Powers of the Regulator

TPR's existing powers are defined in statute, and fall into three broad categories:

- investigating schemes: how it gathers information to help identify and monitor risks;
- putting things right: what it can do where problems have been identified; and
- acting against avoidance: how it will ensure that employers do not sidestep their pension obligations.

Investigating schemes

TPR collects data through an annual scheme return. It also expects to receive reports of significant breaches of the law from whistleblowers, and reports of notifiable events from trustees and employers. The Pension Schemes Act 2021 creates the structure for expanding these events and the information required; this has not yet been fully implemented, although stronger penalties for failure to notify are already in place.

Trustees or scheme managers are also responsible for notifying it promptly of changes to registrable information such as the scheme's address, details of trustees, or the types of benefit provided by the scheme. It also expects to receive reports where a scheme is unable to comply fully with the scheme funding framework.

In addition, it can demand relevant documents (or other information) from trustees and employers, among others. The Pension Schemes Act 2021 broadened TPR's powers to permit it to require a broad range of people to attend an interview; and extended the grounds on which TPR can inspect premises.

Putting things right

Where TPR decides that action must be taken to protect the security of members' benefits, it has a range of options available. The action taken will depend on the circumstances of the problem. These are some examples of the regulatory action:

- issue an 'improvement notice' to individuals or companies, or a 'third party notice', requiring specific action to be taken within a certain time;
- take action, on behalf of a scheme, to recover unpaid contributions from the employer if the due date for payment has passed;
- where a wind-up is pending and members' interests may be at risk, it can issue a 'freezing order'; this order temporarily halts all activity within the scheme, so that it can investigate concerns and encourage negotiations;
- imposing a schedule of contributions on a scheme
- prohibition of trustees who it does not consider to be fit and proper persons for the role;
- imposition of fines where breaches have occurred; and
- prosecution of certain offences in the criminal courts.

Acting against avoidance

TPR has powers to act where it believes that an employer is deliberately attempting to avoid its pension obligations, leaving the PPF to pick up its pension liabilities. To protect the benefits of scheme members, and to reduce the PPF's exposure to claims for compensation, TPR may issue any of the following:

- ***Contribution notices*** — where there is a deliberate attempt to avoid a statutory debt, these allow it to direct that those involved must pay an amount up to the full statutory debt either to the scheme or to the Board of the PPF.
- ***Financial support directions*** — these require financial support to be put in place for an underfunded scheme where it concludes that the sponsoring employer is either a service company or is insufficiently resourced.
- ***Restoration orders*** — if a transaction involving the scheme's assets has been undervalued (for example assets sold to some connected party at a price that is less than what would be expected from a genuine arm's length transaction), these allow it to take action to have the assets (or their equivalent value) restored to the scheme.

A clearance procedure is available for anyone who wishes to confirm that they will not be subject to either a contribution notice or a financial support direction following a proposed transaction. By obtaining advance clearance from TPR, the company receives assurance that that it can go ahead with the transaction without the risk that TPR will at some later stage use one of the anti-avoidance powers described above in relation to that transaction.

In 2018 TPR set out a new approach to regulation, noting that schemes could expect the volume and frequency of their interactions with TPR to increase. In particular, one-to-one supervision was introduced for 25 of the biggest schemes and was expected to increase over that year to involve more than 60 schemes. In addition, higher volume supervisory approaches were introduced, to address risks and influence behaviours, with the Regulator stating that hundreds of schemes were expected to experience the higher volume supervisory approaches over time.

1.1.2 The Regulator and Scheme Governance

TPR regards pension scheme governance as highly important. In 2017 the Regulator launched its 21st century trusteeship campaign to clarify its expectations of trustees and to make clear what its enforcement action is likely to be when these governance standards are not met. The campaign has covered the following governance themes:

- Good governance
- Clear roles and responsibilities
- Clear purpose and strategy
- Trustee training and improving your knowledge
- Skills and experience
- Advisers and service providers
- Managing conflicts of interest
- Managing risk
- Meetings and decision-making
- Value for members

Its dedicated webpage on **governing the scheme** includes various guides and tools that are available to help trustees manage their scheme.

TPR has issued guidance or codes of practice covering many of the key governance areas. It also undertakes regular governance surveys to monitor progress in this area.

General code of practice

In 2021 TPR consulted on the first phase of a new single code of practice that will initially combine 10 of the 15 existing codes of practice, mainly dealing with governance and administration, with the remainder being consolidated in due course. The code incorporates changes introduced by the 2018 governance regulations (implementing key provisions in the EU pensions directive - see 2.3.3). The governance regulations introduce a new duty for schemes to establish and operate an effective system of governance (ESOG), which will be assessed via an Own Risk Assessment (ORA). The new general code of practice came into force on 28 March 2024.

1.2 THE FINANCIAL CONDUCT AUTHORITY

The Financial Conduct Authority (FCA) is responsible for regulating the standards of conduct in financial markets and for supervising the infrastructure that supports those markets. The FCA's remit extends across a range of financial services, including personal pension schemes. Its objectives are:

- to secure an appropriate degree of protection for consumers
- to protect and enhance the integrity of the UK financial system, and
- to promote effective competition in the interests of consumers.

A Memorandum of Understanding between the FCA and TPR sets out the arrangements for cooperation and coordination between the two in carrying out their respective regulatory responsibilities. A joint regulatory guide sets out how the two regulators interact and how they manage any overlaps and ensure consistency. In 2018 TPR and the FCA published a joint regulatory strategy on their approach to regulating the pensions and retirement income sector. The strategy identifies key issues contributing to the prospect of people having retirement income that is either not adequate or not the income they expected.

In December 2022 the regulators published an update outlining how they will continue to work together to deliver good outcomes for pension savers regardless of their pension type. It includes eight joint work streams - broad strategic areas drawing out their current and future focus. These include productive finance; value for money; a regulatory framework for effective stewardship; pension scams strategy; DB transfer advice; DB schemes and transfer activity; pensions dashboards; and supporting consumer decision-making.

Like TPR, the FCA has issued guidance and reports, on subjects such as pension scams, annuity comparison websites and independent governance committees. The FCA also worked to develop standards for the provision of Pension Wise guidance at retirement to members with money purchase benefits.

From 31 July 2023 the FCA's Consumer Duty took effect, aimed at improving how FCA-authorised firms serve their consumers. The Duty is made up of an overarching principle and new rules that firms have to follow. It means that consumers should receive communications they can understand, products and services that meet their needs and offer fair value, and get the customer support they need, when they need it.

1.3 THE PENSIONS OMBUDSMAN

The Pensions Ombudsman investigates and decides complaints and disputes about the way that pension schemes are run. He is completely independent and 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.

Under the Pension Schemes Act 1993, the Pensions Ombudsman has powers to 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.

There is 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 administered by the Pensions Regulator.

Complaints can be made by actual or potential beneficiaries (who believe that they have been unfairly treated by the trustees or employer, or anyone else involved in scheme administration); or by trustees against the employer and vice versa; and disputes among the trustees of the same or different schemes.

Since April 2018 the Ombudsman has taken over responsibility for all pension complaints, including those previously dealt with by TPAS (see below). Before the change, TPAS tended to focus on complaints before completion of the scheme's own Internal Dispute Resolution Procedure (IDRP), and the Pensions Ombudsman typically dealt with those that had gone through the IDRP. The change meant that the Ombudsman began to operate an early resolution service (ERS) in addition to its normal adjudication service (the aim being to provide a quick, informal and streamlined process). However, in June 2024 the Ombudsman announced that it would in future require all complainants to have exhausted the scheme's IDRP before it would consider investigating a complaint under that process.

In August 2019 the DWP responded to a consultation on measures to broaden the jurisdiction of the Pensions Ombudsman. The DWP said that it intended to amend the legislation in due course to allow the Ombudsman to resolve disputes before a formal determination, and to enable an employer to make complaints on its own behalf against a group personal pension provider. This is still awaited.

There is also a Pensions Protection Fund Ombudsman (PPFO) (currently the same person as the Pensions Ombudsman) who can review decisions made or consider complaints of maladministration in relation to the Pension Protection Fund (PPF). Points to note are:

- the PPF's two stage internal procedure must be completed; help to do this is available from the early resolution service;
- the final decision will be made by the PPF Reconsideration Committee;
- for complaints of maladministration, the PPFO may (in some circumstances) be able to review a problem before it has been through the second stage of the PPF process;
- The PPFO can accept applications from anyone who has had a decision made by the PPF Reconsideration Committee.

1.4 THE MONEY AND PENSIONS SERVICE

The Financial Guidance and Claims Act 2018 introduced the single financial guidance body (SFGB), a new statutory body that is accountable to Parliament. The SFGB went live on 1 January 2019 and was rebranded as the Money and Pensions Service (MaPS) from 6 April 2019.

MaPS' mission is to help people – particularly those most in need – to improve their financial wellbeing and build a better, more confident future. Working collaboratively across the UK, its aim is for customers to access high-quality money and pensions guidance and debt advice throughout their lives, how and when they need it.

MaPS has a key role in delivering pensions dashboards (see 2.4.7).

MaPS is funded by levies on both pension schemes and the financial services industry.

1.4.1 MoneyHelper

MoneyHelper (**https://www.moneyhelper.org.uk/en**) is the consumer-facing service provided by MaPS. Created in June 2021, MoneyHelper provides free and impartial money and pensions guidance, bringing together the financial guidance services and content from its legacy brands: the Money Advice Service, the Pensions Advisory Service and Pension Wise (and replacing the websites for these legacy brands).

As well as providing information and tools on its website, MoneyHelper operates a live chat feature, telephone helplines for guidance, and an online enquiry form.

Pension Wise

Pension Wise was launched by the government in April 2015 as a free and impartial guidance service to help those aged 50 or over with defined contribution (DC) pensions to understand their options. Pension Wise is now delivered through MoneyHelper, providing telephone guidance and face-to-face appointments, as well as online information. The guidance must follow a prescribed format to meet FCA standards, and specific recommendations are not made.

From 1 June 2022, new rules were introduced in a bid to improve take-up of pensions guidance. Where a member with flexible benefits (broadly, DC benefits) applies to transfer or start receiving benefits, trustees must refer them to Pension Wise, explain the nature and purpose of the guidance and offer to book an appointment. The new measures are being referred to as a stronger nudge to pensions guidance. They also apply to FCA-regulated pension providers.

Pension safeguarding

Since 30 November 2021, regulations have placed restrictions on the statutory right to transfer, enabling trustees to prevent a transfer going ahead in certain circumstances where they suspect a pension scam. Trustees must carry out checks to determine whether any red or amber flags are present. A red flag prevents the transfer. An amber flag indicates the risk of a scam, meaning the transfer can only proceed when the member has attended a **Pension Safeguarding Guidance appointment** with MoneyHelper and provided evidence that they have done so.

The Pensions Advisory Service (TPAS)

TPAS used to offer free and impartial guidance to people with workplace and personal pension schemes, covering state, company, personal and stakeholder schemes. The service was provided by a nationwide network of volunteer advisers who were supported and augmented by in-house technical and administrative staff. TPAS also operated a national telephone helpline and provided telephone appointments with Pension Wise guidance specialists.

The Money Advice Service

MAS was set up by the Government in 2010 as an independent service tasked with providing free and impartial money advice. In 2012 MAS also took on responsibility for the coordination of debt advice.

In addition to providing money guidance, MAS had responsibility for financial capability and financial education.

1.5 CITIZEN'S ADVICE SERVICE

The Citizen's Advice Service is a charity which aims to provide advice that helps people to overcome their problems. The service is made up of local members, who are all individual charities, along with the national Citizens Advice charity. The Citizens Advice network delivers advice services from local Citizens Advice premises and community centres, doctor's surgeries, courts and prisons across England and Wales.

1.6 THE FINANCIAL OMBUDSMAN

The Financial Ombudsman Service (FOS) is the statutory dispute-resolution scheme set up under the provisions of the Financial Services and Markets Act 2000. The body that administers the ombudsman scheme has a board of directors appointed by the Financial Conduct Authority. The directors appoint the Ombudsman.

In connection with pensions, FOS will consider complaints relating to the sales or marketing of a personal pension (complaints of maladministration are dealt with by the Pensions Ombudsman). It is empowered to award compensation, up to a maximum of £150,000.

Before contacting the Financial Ombudsman, the individual should write to the company about which they have a complaint who will then have eight weeks to investigate and issue a decision. If the member is still unhappy, then FOS can be approached.

The rules setting out how the Financial Ombudsman Service should handle complaints are published as part of the FCA's Handbook. There are procedures in place for ensuring cooperation between the FOS and the FCA on issues that might lead to large numbers of complaints.

1.7 PENSION PROTECTION FUND

1.7.1 Eligibility

The Pension Protection Fund (PPF) came into effect from 6 April 2005. It applies to DB and hybrid schemes (defined contribution schemes are not eligible).

Where a qualifying insolvency event occurs on or after 6 April 2005 (essentially either receivership or insolvency of the sponsoring employer) and the assets of the scheme are not sufficient to fully buy out the benefits otherwise payable by the PPF with an insurance company, then the scheme will go into the PPF. Otherwise, the scheme will have to be wound up, or may be allowed to run as a closed scheme. Schemes that started winding up before 6 April 2005 are not covered.

1.7.2 Compensation

Once the PPF takes responsibility for a scheme, its assets and liabilities are transferred to the PPF, which will provide compensation broadly at 100% of accrued benefits for those over Normal Pension Age (NPA) or those in receipt of an ill health or survivor's pension. For others, the compensation will be 90% of accrued benefits; legislation provides for it to be subject to an overall cap depending on the member's age at the date of commencement of benefits, but following the Hughes ruling (see below) the cap no longer applies (the last published cap was for the year commencing 1 April 2021 when it was £ 41,461.07 p.a. which became £37,314.96 p.a. when the 90% level was applied for benefits commencing at 65). There is also CPI indexation, capped at 2.5%, on compensation attributable to benefits earned through service after 5 April 1997, and a 50% spouse's benefit on death.

The Pensions Act 2014 increased the maximum benefits payable to those with long service in the scheme that entered the PPF. From 6 April 2017, the standard cap (where it applied) was increased by 3% simple for each complete year of service above 20 years, up to a maximum increase of 100% (i.e. double the standard cap).

There have been a number of court cases that have implications for the level of PPF benefits:

- In September 2018, the Court of Justice of the European Union (CJEU) published a ruling in the case of Hampshire v PPF, finding that the PPF must provide compensation of at least 50% of the value of a member's accrued rights in the event of insolvency of the scheme's employer.
- In December 2019, the CJEU gave its ruling in Pensions-Sicherungs-Verein VVaG v Bauer, which related to the German equivalent of the PPF. The Court ruled that where a sponsor become insolvent, a reduction in the amount of occupational retirement benefits paid to a former employee is disproportionate (even at the 50% level under the Hampshire ruling) if it would bring the former employee below a defined poverty threshold.
- In June 2020, the High Court ruled I in the case of Hughes v PPF that the PPF compensation cap constitutes unlawful discrimination on the grounds of age, and that the different treatment of those above and below NPA was not objectively justifiable.

In July 2021 the Court of Appeal ruled on the related Hughes and Hampshire cases. In brief, the Court found that the PPF compensation cap is unlawful and must be disapplied, but that the PPF's approach to determining whether a member's PPF compensation is at least 50% of the value of their original scheme benefits is appropriate. The PPF confirmed that none of the parties involved would appeal those ruling further, and it has released guidance confirming how schemes should take account of the various rulings.

The government is still considering the implications of the Bauer judgment in relation to pre-2024 insolvencies; for schemes with an assessment period starting on or after 2 January 2024, the Retained EU Law (Revocation and Reform) Act 2023 disapplies the Bauer judgment and therefore such schemes need make no allowance for it.

1.7.3 Hybrid Schemes

For hybrid schemes, the Pension Protection Fund regulations set out the procedure for discharging money purchase benefits within schemes that are eligible for the PPF.

1.7.4 The PPF Levy

The main funding of the PPF comes from levies collected annually on eligible schemes. The levy, which is subject to an overall ceiling each year, comprises a risk-based element and a scheme-based element. The scheme-based element considers the amount of the liabilities for providing PPF benefits to the scheme members and the risk-based element broadly takes account of the funding level of the scheme and the risk of employer insolvency. Additional levies are also payable in respect of the fraud compensation scheme and the Ombudsman, and to cover the establishment and administration of the PPF.

1.8 FINANCIAL ASSISTANCE SCHEME

The Financial Assistance Scheme (FAS) was set up by the Government to provide financial assistance to members of schemes that do not qualify for the PPF and who have lost pension rights because their scheme wound up without sufficient funds to meet the pension liabilities.

The scheme was managed by the DWP and administered by the FAS Operational Unit. Responsibility has now been passed to the Board of the PPF.

FAS closed to new applications from 1 September 2016. Existing members, or those with a deferred entitlement to receive assistance payments from the FAS were not affected by this.

1.8.1 Eligibility

To be eligible the scheme must in most cases have started to wind up between 1 January 1997 and 5 April 2005 (although there are some special circumstances in which schemes commencing winding up before 27 March 2014 could qualify).

Originally the requirement was that the employer must be insolvent or no longer exist, or a 'compromise agreement' had been reached with the employer to prevent employer insolvency. However the eligibility conditions were widened to include underfunded schemes where there was no employer debt at the time wind up commenced.

Members are eligible for assistance as are a member's surviving spouse or civil partner who died after the scheme started to wind up.

1.8.2 Compensation

The compensation now given by the FAS is similar to the compensation provided by the PPF. Eligible members' pensions will receive 90% of their accrued pension subject to a cap. This will normally be payable from normal retirement age (NRA). A member can apply for payment earlier on the grounds of ill health but only up to five years before his NRA, and the compensation would be reduced for early payment. Any compensation accrued in respect of scheme service after 6 April 1997 will be increased each year by CPI (capped at 2.5% p.a.).

1.9 THE FINANCIAL SERVICES COMPENSATION SCHEME (FSCS)

The FSCS is a safety net for customers of authorised financial services firms that have failed. It was set up under the Financial Services and Markets Act 2000 (FSMA) to pay compensation where an authorised firm (such as an insurance company) is unable, or unlikely to be able, to pay claims against it. This is generally when a firm is insolvent or has gone out of business.

The FSCS is primarily concerned with protecting private individuals, although small businesses are also covered. The trustees of defined benefit occupational pension schemes are eligible to claim on the FSCS (for example for losses incurred due to the failure of a firm authorised by the Financial Conduct Authority or the Prudential Regulation Authority) provided the sponsoring employer of the scheme is not 'large', as defined in FCA's rules. From 29 April 2016 the FSCS covers all occupational pension schemes providing money purchase benefits, regardless of employer size. Where the pension scheme provides money purchase benefits, the FSCS is required to treat each scheme member as having a claim (up to the £50,000 limit for each member in the case of investment claims).

1.10 GOVERNMENT DEPARTMENTS

1.10.1 HM Revenue & Customs (HMRC)

HMRC (formerly the Inland Revenue) is responsible for the collection and administration of tax and National Insurance (NI). The tax and NI liabilities of pension schemes, companies and individuals are calculated in accordance with legislation. Since the tax regime introduced by Finance Act 2004 (FA04) came into force, HMRC has minimal discretionary powers. However it publishes comprehensive guidance on tax matters and will also answer queries on recent Finance Acts. For pension schemes, the main body of guidance is the Pensions Tax Manual. Other HMRC manuals that will sometimes be relevant include the Employment Income Manual, the VAT Manual and the Inheritance Tax Manual. HMRC also regularly publishes newsletters and other announcements about pensions tax matters.

1.10.2 The National Insurance Contributions and Employer Office (NIC&EO)

The National Insurance Contributions and Employer Office is part of HMRC. It is responsible for collecting and recording National Insurance contributions. This involves

- ensuring compliance with National Insurance-related legislation,
- collecting National Insurance contributions,
- administering the legacy contracted-out system,
- maintaining accurate National Insurance accounts and
- providing information about National Insurance It also deals with enquiries relating to:
- Class 1 National Insurance rates and thresholds
- Statutory Payments
- Married Women's Reduced Rate Election
- National Insurance statement requests
- Class 2 and 3 National Insurance
- Employment Histories

1.10.3 National Insurance Services to the Pensions Industry (NISPI)

The National Insurance Services to Pensions Industry (NISPI) is a directorate within NIC&EO.

NISPI deals with occupational pension schemes that were contracted-out of the State additional pension.

1.11 THE INFORMATION COMMISSIONER

The Information Commissioner's Office (ICO) is an independent authority that seeks to uphold information rights in the public interest, promoting openness by public bodies and data privacy for individuals. The ICO rules on eligible complaints, gives guidance to individuals and organisations, maintains a registry of data controllers and takes appropriate action when the law is broken.

The ICO is responsible for promoting and enforcing data protection law; it interprets the legislation including the Data Protection Act 2018 and the General Data Protection Regulation (GDPR) and provides advice about it.

1.12 THE PENSION TRACING SERVICE

The Pension Tracing Service was introduced to enable members of pension schemes to easily trace the contact address of those schemes. The service is especially important for members who leave a scheme with deferred benefits and, when they come to retire some years after leaving a scheme, have difficulty contacting the scheme to arrange payment of their benefits (for example, where the scheme's administration office has moved). The official government website for members searching for lost pension benefits is https://www.gov.uk/find-pension-contact-details

1.13 THE DEPARTMENT FOR WORK AND PENSIONS

The Department for Work and Pensions (DWP) is the UK's Government department responsible for welfare and pensions policy. DWP's responsibilities include:

- providing information about pensions, benefits and retirement for current and future pensioners;
- providing a decent income for people of pension age and promoting saving for retirement;
- administering the State Pension.

You can browse literature on DWP's website: https://www.gov.uk/government/organisations/department-for-work-pensions

The DWP provides the overarching regulatory and legal framework governing TPR and the PPF. It has no responsibility for the day-to-day running of TPR and the PPF but expects to be informed by them of potentially significant problems.

A tripartite Memorandum of Understanding between the DWP, TPR and the PPF establishes the framework for cooperation between them, including discussion forums, and sets out the role and responsibilities of each body.

1.14 THE TRUSTEES AND SECRETARY TO THE TRUSTEES

1.14.1 The Trustees

The trustees of an occupational pension scheme are the legal owners of the assets of the scheme and they are primarily responsible for ensuring that:

- the scheme is administered in accordance with the relevant legal and regulatory requirements (for DB schemes this includes ensuring that the scheme meets the statutory funding objective);
- the employer's and members' contributions are paid on time; and
- members' benefits are paid on time and in accordance with the trust deed and rules of the scheme.

Trustees owe a number of different legal duties to the beneficiaries of the scheme.

There are a number of statutory requirements that apply to the trustees of most occupational pension schemes. These include the requirement to:

- prepare a triennial actuarial valuation for their scheme and to put in place a schedule of contributions, a statement of funding principles and annual funding report and any recovery plan (DB schemes only);
- put in place a payments schedule (defined contribution (DC) schemes only);
- prepare a statement of investment principles for their scheme (where the scheme has 100 or more members);
- put in place an internal disputes resolution procedure;
- ensure that they do not discriminate against members on grounds of age, sex, race, religious belief, disability and sexual orientation in the operation of their scheme;
- pay cash equivalent transfer values;
- provide members and prospective members with certain prescribed information before they join the scheme and at various times during their membership of the scheme; and
- From April 2015 (if the scheme has DC benefits), appoint a Chair who is responsible for signing a statement on how the scheme complies with the governance standards and charge controls.

1.14.2 Secretary to the Trustees

The trustees of most occupational pension schemes, and certainly the larger schemes, will be supported by a secretary (often, the secretary is the pensions manager). The secretary will be responsible for providing administrative support to the trustees to ensure that the scheme is run correctly. This would typically include:

- organising trustees' meetings; this includes giving notice to the trustees and preparing the agenda for the meetings;
- ensuring that the trustees' meetings are quorate and that any decisions that are taken comply with the requirements set out in the scheme's trust deed and rules (or the articles of association where there is a corporate trustee);
- producing the minutes of the trustees' meetings;
- filing the scheme's annual return and overseeing the preparation of the scheme's annual report and accounts;
- ensuring that the necessary formalities are complied with on the appointment and removal of trustees or the directors of a corporate trustee;
- ensuring that the information required by the Pension Protection Fund in connection with the calculation of the scheme's PPF levy (and any PPF contingent assets) is filed on time each year and that the levy is paid; and
- liaising with trustees' advisers on administrative matters.

1.15 INDEPENDENT GOVERNANCE COMMITTEES

From 6 April 2015, providers of workplace contract-based schemes such as group personal pensions are required to operate Independent Governance Committees (IGCs) to act in the interests of policyholders, and independently from the provider, to assess the value for money delivered by these schemes.

As well as providing communication to scheme members and employers, IGCs enable greater transparency and comparability between contract-based schemes (group personal pension and stakeholder schemes). IGCs must report on how they meet minimum quality standards. They have the power to escalate concerns to members, employers and the Financial Conduct Authority (FCA).

The chair of the IGC is responsible for publishing an annual report setting out the assessment of the value for money delivered by the schemes they oversee, how schemes meet the standards and how the IGC has acted in policyholders' interests over the course of the year.

Providers with smaller and less complex workplace personal pension schemes can establish a Governance Advisory Arrangement (GAA) instead of an IGC.

From April 2020, following consultation, the FCA introduced new rules that require IGCs to publish and disclose costs and charges information to scheme members. This is in line with requirements for trust- based schemes.

Also from 2020, the FCA introduced requirements for IGCs to oversee and report on their firm's ESG issues, and to assess the value for money of investment pathway solutions (the latter requirement was introduced from 1 February 2021).

In October 2021, following consultation, the FCA introduced new rules on assessing value for money for members of contract-based schemes.

1.16 MEMBERS AND THEIR DEPENDANTS

The members and beneficiaries of a scheme include:

- active members (i.e. members who are currently accruing benefits under the scheme);
- deferred members (i.e. members who have ceased to accrue benefits under the scheme and who have a future right to the payment of benefits under the scheme);
- pensioners (i.e. members who are currently in receipt of a pension from the scheme);
- spouses, civil partners and dependants* (who are entitled under the rules of the scheme to the payment of benefits on the death of the member); and
- in an occupational scheme, the employer (the employer is sometimes considered to be a beneficiary under the scheme on the basis that it will generally be entitled to the return of any surplus assets on the winding- up of the scheme and is generally responsible for making up any shortfall in the scheme's funding position).

* *Since April 2015, in DC schemes, as well as paying death benefits to individuals who were financially dependent / interdependent on the member, it is also possible to pay death benefits to other individuals nominated by the member or scheme administrator ('nominees') or to a nominated 'successor' on the death of a dependant, nominee or successor.*

In an occupational scheme, the members and beneficiaries of a scheme are entitled to enforce the terms of the trust deed and rules against the trustees. In a contract-based scheme such as a group personal pension, they can similarly enforce the terms of the contract against the provider. Members may also have certain contractual rights under their contract of employment which they can enforce against their employer.

The rules of the scheme should set out the eligibility requirements for membership of the scheme. The eligibility conditions of at least one scheme used by the employer must satisfy the automatic enrolment requirements.

Members are generally required to contribute to their scheme at the rate set out in the rules or their employment contract (which can normally be changed from time to time). Member contributions are normally deducted directly from their salary and paid across to the trustees of the scheme by their employer. Alternatively, in some schemes all the contributions may be paid by the employer (so-called non- contributory schemes); or the member may have the choice of opting under a 'salary sacrifice' or 'flexible benefit' arrangement for a reduced salary in return for not having to contribute to the scheme (such arrangements may be efficient from a National Insurance point of view).

1.17 EMPLOYERS/PENSIONS MANAGER, PAYROLL AND HR

1.17.1 The Employer

Payment of contributions – DB schemes

The employer is generally responsible for making up any shortfall in the scheme's funding position. Normally the employer and trustees will agree the rate of employer's contribution to the scheme. In some cases, however, the trustees have a unilateral power to set employer contributions. The rate of employer's contributions will be set out in the scheme's schedule of contributions. The employer will also be responsible for deducting members' contributions from their salary and for paying them across to the trustees of the scheme within strict timescales.

Payment of contributions – DC schemes

The employer is responsible for paying contributions at the rate which is specified in the trust deed and rules of an occupational scheme, or in accordance with the employment contract in the case of a contract-based scheme such as a personal pension.

Where automatic enrolment applies, the contributions must satisfy at least the minimum requirements under automatic enrolment. The employer will also be responsible for deducting members' contributions from their salary and for paying them across to the trustees or managers of the scheme.

The employer's powers and obligations under trust-based schemes

The employer will also typically have a number of powers that it can exercise under the trust deed and rules of a scheme (e.g. power to amend the scheme, power to appoint and remove trustees, etc.). The exercise of these powers by the employer may be subject to the consent of the trustees. It may also be restricted by statute or by the courts.

In the case of ***Imperial Group Pension Trust v Imperial Tobacco*** (1991) the court held that the powers held by an employer under an occupational pension scheme are subject to an implied duty of trust and confidence that exists between an employer and its employees. Therefore, an employer must exercise its powers under an occupational pension scheme in a way that is consistent with this duty. However, it is generally not considered difficult for an employer to comply with this duty. It can still act in its own interests provided it is not being dishonest with its employees.

The employer also owes a number of legal and contractual obligations to its employees based on the general law relating to employment and the employees' contracts of employment.

Where the scheme is a group scheme providing benefits for employees of one or more associated companies, one of the employers will act as the principal employer. The principal employer would normally be granted special powers or duties under the scheme's trust deed and rules, for example, appointing and removing trustees, power to amend the scheme and determining when the scheme should be wound up. The principal employer will also normally be nominated to represent the other participating employers in negotiations with trustees over issues such as scheme funding and the scheme's statement of investment principles.

Other trust-based schemes have been established for the use of a number of companies that are not associated. This includes industry-wide schemes for employers in a particular sector, and a more recently popular variant which is the master trust scheme in which any employer can participate (NEST being an example).

1.17.2 The Pensions Manager

Where the employer is using an occupational scheme, it may employ a pensions manager (and sometimes a pensions team) to oversee the day-to-day operation of the scheme and help it run effectively. The pensions manager is typically responsible for a variety of tasks including any or all of the following:

- managing a team of pensions administrators and advisers
- acting for the trustees as the specified person to handle disputes under a dispute resolution procedure
- planning new pension schemes and developing existing ones
- reporting on the scheme's financial performance
- liaising with actuaries, solicitors, auditors, investment consultants and trustees
- liaising with payroll and HR (see 1.5.3 below)
- promoting the pension schemes
- preparing annual financial reports.

Often, the pensions manager will also act as secretary to the trustees (see 1.14.2 above).

1.17.3 Payroll and Human Resources (HR)

The employer may operate separate or combined Payroll and HR departments. The HR team will have responsibility for the development, recruitment and promotion of staff. This will include liaising with the pensions manager on pension arrangements and ensuring compliance with auto-enrolment requirements (see further Part 3, Chapter 3). The HR team will advise payroll of any changes to staff (joiners & leavers) and changes to salaries or pension scheme contributions.

The payroll team will process the weekly/monthly payroll requirements for the business, liaising with HR and Finance in order to receive and process payroll related data. Payments to be processed include salary, benefits and deductions. The payroll team will also be responsible for handling the monthly pension scheme in line with payroll and the Scheme requirements. This will include adding or removing members, changing contribution amounts and providing data to the HR team, pensions manager and service providers as required. The payroll team may also operate a pensioner payroll including any increases due.

1.18 ADVISERS

Trustees' Advisers

The trustees of an occupational scheme will appoint a number of different advisers to assist them in the running of their scheme. This will include:

- a legal adviser
- a fund manager
- an actuary
- an auditor

all of whom must be appointed in writing and their appointment must comply with the requirements of section 47 of the Pensions Act 1995.

Advisers will typically also include one or more of an investment consultant, a benefits consultant, and a communications or member engagement consultant.

Statutory Duties

In certain circumstances advisers may themselves be subject to statutory duties in relation to the scheme, such as the provisions of:

- The Financial Services and Markets Act 2000 (FSMA) (in the case of investment advisers); or
- The Pensions Act 2004 (which requires advisers to report breaches of the law relevant to the administration of the pension scheme which are likely to be of material significance to TPR).

1.18.1 Legal Adviser

The role of the trustees' legal adviser will include:

- advising the trustees on their legal duties and responsibilities;
- advising the trustees on the legal and regulatory requirements that apply to their scheme;
- advising the trustees on the interpretation of the scheme's governing documentation;
- drafting any changes that need to be made to the scheme's trust deed and rules and other documents such as deeds of appointment and removal of trustees;
- drafting documents such as recovery plans, merger agreements and contingent asset agreements;
- advising on the legal aspects of corporate transactions and drafting the sale and purchase agreement; and
- advising on disputes in relation to the scheme.

1.18.2 Investment Adviser

Pension investment advisers work in the following areas.

Investment Monitoring

They update clients on the short and long-term performance of their scheme assets by providing in depth quarterly, bi-annual or annual investment reports.

Investment Strategy Modelling

They advise on the most appropriate asset allocations for scheme assets, using an asset liability model. They review long-term investment strategies on an annual basis and/or three year basis.

Investment Manager Research & Selection

They research, monitor and recommend a range of high-quality investment managers within the market place across all asset classes from equities, fixed income, property and alternatives.

Asset Transition Management

They coordinate and manage the transfer of assets between asset classes and investment managers.

Investment Trustee Training

They provide training for trustees, to introduce them to advanced investment concepts, for example, the benefits of diversification, risk assessment, and alternative asset classes suitable for trustees of UK based DB and DC pension schemes.

1.18.3 Actuary

The scheme actuary plays an important role in relation to DB schemes, in:

- assessing the funding position of the scheme;
- preparing the triennial actuarial valuation, the interim funding reports and advising on the terms of the funding arrangements for the scheme, including the suitability of the scheme's schedule of contributions and recovery plan (if any);
- advising the trustees on the methods and assumptions that should be used to set the scheme's technical provisions;
- calculating members' benefit entitlements (including ill health pensions, early/late retirement pensions and cash equivalent transfer values);
- advising the trustees on the assumptions that should be used to calculate transfer values; and
- calculating any 'section 75' debts on the employer that become payable in respect of the scheme usually when an employer becomes insolvent, the scheme winds up, or in the case of a multi-employer scheme, when one of the employers is deemed to have ceased to participate in the scheme.

1.18.4 Auditor

The auditor's primary responsibility is to audit the annual scheme accounts. The auditor may also advise the trustees on the adequacy of the internal controls that they have in place to protect the scheme's assets.

1.18.5 Benefit Consultant

The benefit consultant advises the trustees on good practice when it comes retirement provision, and can advise and assist when the trustees are considering making changes to the scheme.

1.18.6 Communication/Engagement Consultant

The communication/engagement consultant advises the trustees on good practice in the area of member communications and engagement. This often includes helping the trustees devise and implement a strategy for member communications, both for business as usual, and during times of change.

Employers' Advisers

In practice, a sponsoring employer for an occupational pension scheme will also appoint legal and actuarial advisers. These may be the same as the trustees' advisers, although this is much less common than it once was because of the potential for conflicts of interest which may arise. If the employer and the trustees use the same adviser (or firm of advisers) and any conflict occurs, the employer/trustees may need to take advice from a different adviser.

An employer will also appoint an adviser in connection with a contract-based group arrangement.

An employer may appoint a communication/ engagement consultant to help them with engaging their employees in the importance of retirement savings. If the employees understand this, they are more likely to appreciate the sponsor's contribution to the scheme and how the pension scheme forms a major part of the rewards package.

Members' Advisers

There will be occasions when some or all of the members need advice.

In a DB scheme, an employer undertaking an 'incentive exercise' may arrange for advice to be made available to the members involved – indeed, one of TPR's published principles relating to such exercises is that the employer should make independent and impartial financial advice available to all members and ensure that it is strongly promoted. In limited circumstances this may not be appropriate, in which case detailed guidance should be provided instead. Examples of incentive exercises are invitations to members to surrender their right to future pension increases in return for a higher, but not increasing, pension; and an invitation to transfer their benefits out of the scheme in return for a higher transfer value than would normally be available. In both cases, the motivation for the scheme sponsor is normally to reduce the risk or cost to the scheme.

In a DC scheme, advice may be needed when a member starts drawing his benefits. Such advice can cover the different options available and/or the best product for the option chosen (for example where the member has chosen an annuity, the best rate available in the market for the type of annuity selected). Less commonly, members may seek advice on investment strategy during the accumulation phase.

Advice may also be sought when a member wishes to transfer out of either a DB or DC scheme. In the case of a DB scheme, it is a statutory requirement that advice is taken where the value of the benefits is £30,000 or more and a transfer is being used to access the new pension flexibility. Many DC providers will in any case insist on advice having been taken before accepting a transfer from a DB arrangement and have done so for a number of years.

In addition to advice, members can also obtain general guidance from a number of sources. One such source is Pension Wise (the service set up by the Government in connection with the new pension flexibilities) which provides free and impartial guidance on DC pensions over the phone or face-to-face. Such guidance stops short of recommending any particular product or advising the member what to do with his pension pot.

1.19 SERVICE PROVIDERS

Pension scheme trustees may also appoint other service providers to assist them with the day-to- day running of their scheme. This may include:

- an administrator - to perform various administrative functions, such as paying members' benefits and transfer values and maintaining membership records;
- a consultant - to advise them on strategic decisions in respect of the scheme (e.g. whether or not to buy out some or all of their members' benefits);

Where trustees delegate any of their functions to a third party (such as an administrator), they should first ensure that they have the power to do so under their scheme's trust deed and rules. Trustees should also regularly monitor the performance of any service provider to whom they have delegated any of their functions.

1.20 INVESTMENT MANAGERS

The trustees of an occupational pension scheme are ultimately responsible for the investment of the scheme's assets. However, in practice, most trustees will delegate their day-to-day investment responsibilities to investment managers authorised by the Financial Conduct Authority (FCA).

The FCA requires investment managers to comply with a large body of rules. These are designed to ensure that investment managers:

- have minimum asset levels; and
- are members of a compensation scheme or have indemnity insurance arrangements in place.

An investment manager should be appointed in writing by the trustees. The terms of engagement which investment managers enter into with trustees should in particular include:

- the trustees' investment objectives;
- particular market restrictions;
- particular investment restrictions;
- warnings of investments that are difficult to realise;
- details of how to terminate the agreement;
- arrangements for communicating with the trustees;
- special warnings where investment is made in futures and options; and
- special rules for portfolios managed on a discretionary basis.

These terms of engagement will take the form of a standard set of terms and conditions that are reviewed by the trustees' legal advisers, with amendments being negotiated as appropriate. Following investigation into the market for asset management, the Competition and Markets Authority (CMA) published an Order that introduced new duties for trustees from December 2019. Among the requirements, is that trustees must carry out a competitive tender before appointing fiduciary managers and must set strategic objectives for investment consultancy providers. From 1 October 2022, DWP regulations introduced requirements on trustee oversight of investment consultants and fiduciary managers that replace those in the CMA Order. The Pensions Regulator is responsible for monitoring compliance and does this via the scheme return.

Trustees who delegate any of their investment functions to an investment manager are not responsible for the acts or defaults of the investment manager in the exercise of those functions provided they have taken all reasonable steps to satisfy themselves that:

- the investment manager has the appropriate level of knowledge and experience to manage the investments of the scheme; and
- the investment manager is carrying out his work competently and is complying with the requirements of section 36 of the Pensions Act 1995 and those contained in the Occupational Pension Schemes (Investment) Regulations 2005.

To fulfil their obligation to monitor the investment manager, the trustees should ask to see regular reports from the investment manager.

1.21 INSURER

Insurers provide contract-based schemes such as personal pensions and stakeholders. However they can also have a role in trust-based schemes (other than a purely investment role):

In a trust scheme, the trustees (or employers) may choose to insure some or all of the benefits that are provided under their scheme (e.g. lump sum death benefits) with an insurer, provided the rules of the scheme allow them to do so. Trustees may also purchase annuities to secure some or all of the members' benefits under the scheme (e.g. to secure pensions in payment under their scheme).

In the case of a DB scheme, the insurance or annuity policy will generally be issued in the name of the trustees (or, where appropriate, the employer).

In these circumstances the relationship between the trustees (or the employer) and the insurer will be contractual and the trustees (or the employer) will be able to sue the insurer to enforce the terms of the policy.

In some circumstances, policies may be issued to named beneficiaries (e.g. where a scheme is being wound up). Where this happens, the beneficiaries can directly enforce the policy against the insurer. In addition, a policy that was originally issued in the name of the trustees (or the employer) may be assigned (for example, on a wind- up of a DB scheme) to the beneficiary. Once the policy has been assigned the beneficiary will be able to enforce the policy directly against the insurer.

If a policy is issued to the trustees or an employer and has not been assigned, it may still be possible for the beneficiaries to enforce the policy against the insurer under the Contracts (Rights of Third Parties) Act 1999. However, insurers normally exclude the application of that Act to ensure that beneficiaries cannot enforce policies directly. If that is the case, then the beneficiaries' rights to payment of benefits arise either:

- against the employer, as a claim under the contract of employment; or
- against the trustees, as a claim for benefits under the terms of the scheme's rules.

In addition, it was decided in the case of ***Century Life v Pensions*** Ombudsman (1995) that a complaint by a member against an insurance company for maladministration of his benefits is possible, in principle, if the insurer is in practice the "manager" (but not necessarily the trustee) of the scheme.

A trust scheme, particularly one providing defined benefits, may also use an insurer to provide an AVC facility whereby members can make top-up contributions on a money purchase basis to increase their retirement provision. In this situation, although the insurer provides access to the funds that the contributions are invested in, and the insurer will issue various communications, it is the trustees who are ultimately responsible for providing the AVC benefits to the member. (The exception to this is where the AVC is a Free-standing arrangement, a situation which is now uncommon.)

In the case of DC schemes, where the member is taking an annuity, normally the member will select the Open Market Option to use his pot to buy an annuity from an insurer offering competitive rates. In this case, the annuity will be written in the name of the member.

Summary

The members and beneficiaries of a scheme include:

- active members;
- deferred members;
- pensioners;
- spouses, civil partners and dependants; and
- the employer.

The members and beneficiaries of a scheme are entitled to enforce the terms of the trust deed and rules against the trustees.

The employers in relation to a DB scheme are generally responsible for making up any shortfall in the funding of the scheme.

The powers held by an employer under an occupational pension scheme are subject to an implied contractual duty of trust and confidence that exists between an employer and its employees.

The trustees of a pension scheme are the legal owners of the assets of the scheme and they are primarily responsible for ensuring that:

- the scheme is administered in accordance with the relevant legal and regulatory requirements (for DB schemes this includes ensuring that the scheme meets the statutory funding objective);
- the employer's and members' contributions are paid to the scheme on time; and
- members' benefits are paid on time and in accordance with the trust deed and rules of the scheme.

The trustees of an occupational pension scheme are ultimately responsible for the investment of the scheme's assets. However, in practice, most trustees will delegate their day-to-day investment responsibilities to an investment manager.

The trustees of an occupational scheme will appoint several different advisers to assist them in the running of their scheme.

Self Test Questions

- Identify the members and beneficiaries under a pension scheme.
- What is the role of the trustees in relation to a pension scheme?
- What are the requirements that the FCA places on investment managers?
- List the advisers that trustees normally

Part 3

STATE BENEFITS, NEST AND AUTOMATIC ENROLMENT

OVERVIEW

This part considers the different benefits that are provided by the State and how these interact with and impinge on benefits provided by private arrangements (both occupational schemes and personal pensions).

The first two Chapters explore State retirement pensions and their interaction with private pension provision. Chapter 1 explains the different pension benefits provided by the State. Chapter 2 considers other State benefits that may be provided if certain conditions are satisfied.

Chapter 3 explains the automatic enrolment regime that came into effect in 2012, and the National Employment Savings Trust (NEST). Technically, NEST is a private pension scheme rather than a State arrangement. However, it is a government initiative, and is established and run by bodies created by Act of Parliament, headed by Government appointees. It is therefore convenient to include NEST in this Part.

When you have completed this Part you will be aware of the pension benefits provided by the State and understand how contracting out works, its purpose and effects. You will also understand the basic structure of Master Trusts, including NEST, and how they fit into the pensions landscape following the introduction of automatic enrolment.

CHAPTER 1

State Retirement Pensions

INTRODUCTION

This chapter describes the principal pensions provided by the State, as well as the Pension Credit, a benefit that is payable to those in retirement with a total income below a certain level.

People have an entitlement to State pension according to their history of National Insurance contributions (NICs). The National Insurance scheme operates on a pay-as-you-go basis, meaning that today's contributors are paying for today's social security entitlements and pensions. Payment of contributions entitles an individual or, in certain circumstances, their spouses or civil partners to various social security benefits, depending on the rules in place at the time of the claim. Contributors do not accumulate an individual pension fund of actual monies they have paid which is personal to them.

The State pension is payable from state pension age (SPA) which was historically 60 for women and 65 for men. From 2010, legislation gradually raised the SPA for women so that it aligned with the male age of 65 from 2018. The SPA for both males and females is then subject to further increases (see 2.3).

For those reaching SPA before 6 April 2016, the State Pension had two tiers:

- Basic State Pension
- State additional pensions

For those reaching SPA on or after 6 April 2016, the new State pension is payable.

Deferring State pensions

State Pensions are usually payable from SPA. Usually, however, individuals have the option of not claiming them at that point, in which case payment is deferred. The following options are available:

Where SPA is before 6 April 2016:

- Higher weekly payments – as long as the individual defers for at least 5 weeks, the pension will be increased by 1% for each complete 5-week period that it has been deferred; or
- A one-off lump Sum – if the period of deferment is at least 12 months, then the person can elect to receive a (taxed) lump sum equal to the pension instalments missed plus interest calculated at 2% above base rate.

Where SPA is after 5 April 2016:

- Higher weekly payments – as long as the individual defers for at least 9 weeks, the pension will be increased by 1% for each complete 9-week period that it has been deferred.

State pension triple lock

The triple lock on State pension increases is a government commitment to annually increase the state pension by the greater of average earnings growth, price inflation (as measured by the Consumer Prices Index), or 2.5%. However, this is not guaranteed - legislation provides only for increases in line with average earnings. (The Government did suspend the earnings element just for the 2022/23 tax year because the Covid pandemic had distorted the earnings increase measure for 2021), meaning that the BSP and new State Pensions would rise either by 2.5% or in line with inflation. It is not yet known whether the triple lock will be retained following the July 2024 general election – both the Labour and Conservative parties committed to retaining it for the next Parliament.

1.1 BASIC STATE PENSION (BSP)

This is a flat-rate pension payable to men and women when they reach SPA provided that they have paid NICs for a sufficient period. For those reaching SPA on or before 5 April 2010 the full amount is payable if contributions have been paid or credited for 9/10ths of a person's working life (44 years for a man and 39 for a women). For those reaching SPA on or after 6 April 2010, the number of qualifying years needed for eligibility for the full BSP was reduced to 30. Those with less than the required number of qualifying years were entitled to a proportion of the BSP for each qualifying year they have built up.

The BSP for 2024/25 is £8,814.00 p.a. for a single person and £14,094.60 p.a. for a married couple.

1.2 STATE ADDITIONAL PENSIONS

The State Earnings Related Pension Scheme (SERPS) came into effect on 6 April 1978. SERPS was an earnings-related addition to the basic pension and depended upon the level of earnings between the Lower Earnings Limit (LEL) and the Upper Earnings Limit (UEL). The limits were set each year, but while there is no direct link, historically the LEL has been set at similar levels to the BSP and the UEL has been set at similar levels to the higher rate tax threshold. The original intention was that SERPS would provide 25% of earnings within this band but SERPS was made less generous on two separate occasions. When it was finally replaced by the State Second Pension (S2P) on 6 April 2002 it was targeting a pension of approximately 20% of earnings between the upper and lower limits.

From 6 April 2002, individuals started earning S2P instead of SERPS, although they retained the right to the SERPS pension they had earned up to that point.

S2P provided improved benefits for the lower paid compared to SERPS by:

- adopting a Lower Earnings Threshold (LET), initially £9,500 (increasing in line with average earnings); anyone earning above the LEL but below the LET was treated as having earnings at the LET level.
- providing a higher initial accrual rate on earnings between the LEL and the LET.

In the past, occupational schemes and personal pensions were allowed to replace part of the State benefits by setting up their own arrangements and paying lower NI in return. This is known as contracting out.

1.2.1 Contracting Out

Contracting out has not been available since April 2016, when the new State Pension came into effect.

Prior to this, when contracting out, a person gave up part or all of his/her State Additional Pension entitlement in return for a National Insurance reduction. This was restricted to people who were members of private pension schemes that satisfied certain conditions – essentially ensuring as far as possible that the State Additional Pension given up would be replaced by a broadly equivalent benefit from the private scheme.

A pension scheme that contracted out agreed to provide a minimum level of pension benefits, or the investment proceeds of a minimum level of contributions, in lieu of the S2P (and the State Earnings Related Pension Scheme prior to 6 April 2002). When a pension arrangement was contracted out, both the members and the sponsoring employer paid NICs at a reduced rate because no S2P benefits were being provided by the State for employees who were in contracted out employment.

Prior to 6 April 2012, there were a number of ways in which a pension arrangement might be contracted out:

1. Contracted Out Money Purchase (COMP) Scheme
2. Contracted Out Mixed Benefit (COMB) Scheme
3. Appropriate Personal Pension (APP)
4. Stakeholder pension scheme
5. Contracted Out Salary Related (COSR) Scheme

From 6 April 2012 contracting out on a money purchase basis (i.e. the first 3 options) was abolished. And from 6 April 2016, the final method of contracting out was abolished, and it was therefore no longer possible for a scheme to be contracted out.

1.2.2 Reasons for Contracting Out

The principal financial reasons behind the decision to contract out were as follows.

- For schemes contracting out on a money purchase (or protected rights) basis, the prospect of investing the NI savings to achieve higher benefits than the S2P benefit given up. This applied to COMPS, APPs and the DC part of COMBS.
- For DB Schemes the prospect of providing the contracted-out benefit in the scheme at lower cost than the value of the NI rebate received.

With a COSR scheme, the employer took on the liability of providing earnings related benefits of at least a minimum level. This is known as the Guaranteed Minimum Pension, or GMP. In broad terms, for a member in a COSR, the additional State pension that he would otherwise have been entitled to was reduced by an amount approximating to the GMP provided by the scheme. The occupational scheme would also provide benefits in excess of the GMP. Different rules apply to how GMP and excess benefits are treated, for example in terms of: the minimum increases that apply between the date the member leaves the scheme and the date he retires ('revaluation'); the minimum increases that apply once the pension comes into payment ('indexation'); the earliest date the pension can come into payment (the GMP only comes into payment at GMP age even if the member's pension starts before then); exchanging pension for a lump sum at retirement ('commutation' – GMP is non-commutable).

When contracting-out ceased on 6 April 2016, HMRC stopped tracking GMPs and no longer issues statements to individuals or schemes upon retirement or death confirming the GMP payable. Also, schemes do not need to advise HMRC of any movement of contracted out rights (e.g. transfers) from that date but do still need to track such movements themselves. HMRC set a deadline of March 2019 for pension scheme administrators and trustees to reconcile the membership and GMP data held on scheme records with HMRC's records; after this date HMRC will not make any further amendments to its records. This process also involves reconciling (and if necessary settling) the financial account for each scheme.

Although since 6 April 2016 contracting out through a COSR has no longer been possible, members of former COSRs retain rights to GMPs, and the regulations applying different rules to GMP and non-GMP benefits remain in force. While there are provisions to allow schemes to convert GMPs into normal scheme benefits of equal actuarial value, thus simplifying administration (these have been in force from 6 April 2009) there are a number of technical problems that have made conversion difficult in practice.

There has been a long-running question of whether schemes have to equalise for the effect of unequal GMPs. In October 2018 the High Court published its ruling in a GMP equalisation case involving the Lloyds Banking Group, which concluded that the trustees are under a duty to equalise benefits to remove the inequality caused by GMPs. Further hearings took place to deal with supplementary questions. This addressed a long-standing area of uncertainty for schemes and has been a hot topic in the industry. A cross- industry GMP Equalisation Working Group (GMPEWG), chaired by the Pensions Administration Standards Association (PASA), has been issuing guidance for the industry. Separately, HMRC has published newsletters giving guidance on pensions tax issues that arise when benefits are equalised for the effects of unequal GMPs. The Pension Schemes (Conversion of GMP) Act 2022 is intended to allow for clarification of certain technical aspects of the existing GMP conversion legislation, which many schemes intend to use as part of their GMP equalisation projects. The provisions set out in the Act will require regulations to bring these amendments into force and to add further details. These are expected to be consulted on in due course.

When a member contracted out on a money purchase basis, the reduction in NICs was paid into the scheme by way of a NI rebate. The rebates, together with investment returns in the scheme, built up to form part of the member's total fund known as protected rights (the name derives from the fact that protected rights were subject to certain additional restrictions compared with benefits from non-protected rights funds). The additional State pension that the member would otherwise have been entitled to is reduced to reflect the contracted out period in a similar way to in a COSR scheme. Following the abolition of contracting out on a money purchase basis from April 2012, the distinction between protected rights and non-protected rights has little practical significance as the regulatory restrictions relating to the former have now fallen away.

1.3 PENSION CREDIT

Pension Credit was introduced on 6 October 2003 and replaced the Minimum Income Guarantee, targeting pensioners on low and modest incomes. It has two elements, the Guarantee Credit payable from the female SPA (see the introduction to this Chapter) and the Savings Credit payable from the male SPA. (Note however that the term 'Pension Credit' is often used when strictly speaking only the Guarantee Credit is meant.) It can be claimed by one member of a couple, but not both.

The Guarantee Credit is a means-tested benefit which is paid if the income of the person, and where applicable, partner, is below a certain level, taking into account a notional income from capital. For this purpose, undrawn pension rights will be taken into account as capital. Where the individual has drawn and spent the proceeds of his pension pot (or other capital) for the purpose of securing an entitlement to pension credit, he will be treated as deliberately depriving himself of capital. In this case he will be treated as still being in possession of that capital (i.e. a notional figure will be used for the purpose of the pension credit calculations). The deprivation rule will not apply where the money was spent on reducing or paying off a debt, or on purchasing goods or services if the expenditure was reasonable in the circumstances. It is the individual's responsibility to inform the DWP when they take money from their pension pot.

For 2024/25 it guarantees an income of at least:

- £218.15 per week if they are single
- £332.95 per week if they have a partner

The Savings Credit is intended to reward those on modest incomes who have saved for their retirement during their working life. It is paid to those who have attained the male SPA and who have made some provision towards their retirement. The credit works by providing an income of 60p for each £1 of income between a lower limit and the Guarantee Credit amount above. For 2024/25, the lower limit is:

- £189.80 per week if they are single
- £301.22 per week if they have a partner

This means that the maximum amount of Savings Credit in 2024/25 is:

- £17.01 per week if they are single
  (= 0.6 x [218.15 – 189.80])
- £19.04 per week if they have a partner
  (= 0.6 x [332.95 – 301.22])

To focus the benefit on the less well off, when the person's income reaches the level of the Guarantee Credit, the Savings Credit tapers off. This is done usually by reducing it by 40p for each £1 of income above the Guarantee Credit level.

Note that the new State Pension (see 1.4) has been purposefully set at a level that exceeds the level of the Guarantee Credit for a single person (although not all individuals reaching SPA from 6 April 2016 will be eligible to receive the new State Pension at the full level).

With some exceptions, Savings Credit does not apply to those reaching SPA after 5 April 2016.

1.4 NEW STATE PENSION

For those reaching SPA after 5 April 2016, the BSP and the State additional pensions above were replaced by a new flat-rate pension. This is set above the basic level of the Guarantee Credit, and the Savings Credit is not generally available. Individuals who reached SPA before 6 April 2016 receive pension under the previous rules, whether or not they actually claimed their pension before that date.

The full new State Pension is payable to individuals with 35 or more qualifying years who reach SPA on or after 6 April 2016. Qualifying years are determined in the same way as under the BSP, derived from National Insurance contributions either paid, treated as paid or credited on earnings of at least 52 times the Lower Earnings Limit.

A reduced rate of new State Pension is payable to individuals with between 10 and 35 qualifying years. The reduced rate is 1/35 of the full rate for each qualifying year - so based on the 2024/25 rate of £221.20 per week as the full rate, a worker would earn £6.32 per week in State Pension for each qualifying year.

The self-employed are also eligible for the new State Pension.

An increased weekly pension amount is available to individuals choosing to defer their new State Pension beyond SPA (see the Introduction to this Chapter). However there is no lump sum option.

For those with qualifying years before 6 April 2016, allowance is made for the State Pension already accrued. This is achieved by comparing the total of the BSP and S2P accrued for qualifying years up to 5 April 2016 with what the new State Pension would be based on the same qualifying years. (In both cases, a deduction is made to reflect any period of contracted out service.) The greater of the two then becomes the individual's Starting Amount (previously referred to as the foundation amount):

- If the Starting Amount is lower than the new State Pension at its full rate (i.e. based on 35 or more qualifying years) then, the individual can use future qualifying years to accrue further pension under the new rules, up to the level of the full rate of State Pension.
- If the Starting Amount exceeds the full rate of new State Pension, the excess is a "protected payment". This excess will be increased (in line with prices) but no further pension can be earned through future qualifying years.

Summary

In old age, people can receive State benefits. Before April 2016 these were in the form of the BSP (flat-rate), the State Second Pension (earnings related) and Pension Credit (a minimum income guarantee). From April 2016, the benefit is a single-tier flat-rate pension. None of these benefits are pre-funded, all being paid on a pay as you go basis.

Self Test Questions

- How have retirement benefits that are paid by the State changed in recent years?
- How was the State Second Pension calculated?
- What is the difference between the BSP and Pension Credit?
- What is the new State Pension?

CHAPTER 2

Other State Benefits

INTRODUCTION

Note:
All monetary values quoted for State benefits are the relevant rates for the tax year 2024/25.

The socio-political structure of developed economies inevitably involves State intervention. We have already considered taxes: they are part of what governments take. But what do they give back? It has to be what the taxed citizens want, but what precisely and in what priority order? The answer is highly subjective and invariably in a state of flux. The interpretation by successive governments of what a country's citizens want, or perhaps what the governments think they need, is also in a state of flux.

Consequently, the provision of State benefits will constantly change.

In the last decade or so the cost of UK State benefits has become a major concern. In 2012 the Coalition Government enacted the Welfare Reform Act with the stated intention to 'restore the welfare system to one that is fair for society and will make work pay'. This Act was one of the biggest reforms for 60 years, introducing Universal Credit.

Universal Credit, from October 2013, replaced the previous complex myriad of means-tested benefits with a single benefit. The reforms also include a household benefit cap (see section 2.2.8 for further detail), a new Personal Independence Payment to replace Disability Living Allowance and higher penalties for benefit fraud. This benefit is considered further in section 2.2.1.

Employers are also being involved in the payment of benefits and this is considered in section 2.1. The following sections set out the present position including the main benefits payable.

2.1 STATUTORY BENEFITS PAID BY THE EMPLOYER

2.1.1 Statutory Sick Pay (SSP)

When an employee is unable to work due to sickness or disability, employers must make payments for time off sick to at least a minimum level. Therefore, during the first 28 weeks of time off work employers must, as a minimum, make statutory payments.

SSP is payable at a flat rate of £116.75 per week (2024/25 level) irrespective of the employee's income, after the employee has been off work sick for at least four consecutive days. SSP is paid through the employer's payroll and any liability for Income Tax and/or NICs is deducted at source in the usual way.

2.1.2 Statutory Maternity Leave (SML) and Statutory Maternity Pay (SMP)

Employees eligible for SML can take up to 52 weeks' maternity leave. SMP for eligible employees can be paid for up to 39 weeks, usually as follows:

- the first 6 weeks - 90% of their average weekly earnings (AWE) before tax
- the remaining 33 weeks - £184.03 per week (2024/25 level) or 90% of their AWE (whichever is lower).

Tax and National Insurance need to be deducted from SMP payments.

2.1.3 Statutory Paternity Leave and Statutory Paternity Pay

Employees eligible for Ordinary Statutory Paternity Leave can choose to take either one week or two consecutive weeks' leave.

Statutory Paternity Pay for eligible employees is either £184.03 per week (2024/25 level) or 90% of their average weekly earnings (whichever is lower).

Tax and National Insurance need to be deducted from SPP payments.

2.1.4 Statutory Adoption Leave (SAL) and Statutory Adoption Pay (SAP)

Eligible employees can take up to 52 weeks SAL.

SAP for eligible employees is £184.03 per week (2024/25 level) or 90% of their gross average weekly earnings, whichever is lower. It is paid for up to 39 weeks of adoption leave.

Tax and National Insurance need to be deducted from SAP payments.

2.1.5 Shared Parental Leave (SPL) and Statutory Shared Parental Pay (ShPP)

A person may be entitled to Shared Parental Leave (SPL) and Statutory Shared Parental Pay (ShPP).

Partners can share the leave if they are both eligible for SPL, and they can choose how much of the leave each will take. The mother must take a minimum of 2 weeks' maternity leave following the birth (4 if she works in a factory) but then either partner can:

- take the rest of the 52 weeks of leave (up to a maximum of 50 weeks) as Shared Parental Leave (SPL)
- take the rest of the 39 weeks' pay (up to a maximum of 37 weeks) as Statutory Shared Parental Pay (ShPP)

ShPP is paid at the rate of £184.03 per week (2024/25 level) or 90% of their average weekly earnings, whichever is lower. This is the same as SMP except that during the first 6 weeks SMP is paid at 90% of whatever the mother earns (with no maximum).

2.1.6 Statutory Parental Bereavement Leave and Statutory Parental Bereavement Pay

Since 6 April 2020, employees may be entitled to parental bereavement leave following the death of a child under the age of 18 or a stillbirth after 24 weeks of pregnancy. Employees entitled to take leave include natural and adoptive parents, intended parents, and the partners of any of these individuals, as well as those providing day-to-day care for the child (subject to conditions).

Eligible employees are entitled to up to two weeks' parental bereavement leave, irrespective of their length of service. Additionally, subject to satisfying certain conditions, the employee may be eligible to receive statutory parental bereavement pay.

Statutory Parental Bereavement Pay for an eligible employee is either £184.03 a week (2024/25 level) or 90% of their average weekly earnings (whichever is lower).

2.1.7 Employer's Reclaim of Statutory Benefits

Prior to 6 April 2014 it was possible for employers to claim back SSP paid. However this was abolished under the government's Health, Work and Well-Being Initiative. To compensate, the Employment Allowance was introduced in April 2014; this means that businesses and charities can claim an annual discount (which since April 2022 has been £5,000) on their NICs bill (or can be exempted from paying NICs if their NICs bill is less than £5,000 in tax year).

Reclaims of SMP, SPP, SAP and ShPP are more straightforward in that payments made can be offset against NICs or tax without limit. From 3 April 2011, the employer can claim back either:

- 92% of any SMP etc. payment made, or
- 103% if they qualify for Small Employers' Relief (SER).

2.2 OTHER BENEFITS PAID BY THE STATE

People may also claim the following, depending on their circumstances.

2.2.1 Universal Credit

Universal Credit is a single payment for people who are looking for work or on a low income. It is designed to help claimants and their families to become more independent and is intended to simplify the benefits system by bringing together several working-age benefits into a single payment. Starting from October 2013, Universal Credit was rolled out across the UK in stages over several years. It is not intended that Universal Credit will replace all benefits; certain non-means-tested benefits remain.

The main differences between Universal Credit and the welfare system it is replacing are:

- Universal Credit is available to people who are in work and on a low income, as well as to those who are out of work
- most people are expected to apply online and manage their claim through an online account
- Universal Credit is responsive – as people on low incomes move in and out of work, they will get ongoing support, giving people more incentive to work for any period of time that is available
- most claimants on low incomes will still be paid Universal Credit when they first start a new job or increase their part-time hours
- claimants receive just one monthly payment, paid into a bank account in the same way as a monthly salary
- support with housing costs goes direct to the claimant as part of their monthly payment.
- As incentives to work and to reduce reliance on benefits, individuals are expected to agree to various requirements such as work preparation and keeping in touch with the labour market as a condition of continuing to receive benefits.

Universal Credit is replacing:

- Income Support;
- Income-based Jobseeker's Allowance;
- Income-related Employment and Support Allowance;
- Housing Benefit;
- Child Tax Credit; and
- Working Tax Credit.

The following non-means-tested benefits are outside Universal Credit and remain in place:

- Contributory Jobseeker's Allowance;
- Contributory Employment and Support Allowance;
- Disability Living Allowance;
- Child Benefit;
- Bereavement benefits;
- Statutory Sick Pay;
- Statutory Maternity Pay;
- Maternity Allowance; and
- Industrial Injuries Disablement Benefit.

There is a withdrawal rate of 55% (to be applied to employed earnings net of tax, National Insurance and pension contributions). This was initially 65% then reduced to 63% from 10 April 2017 to 23 November 2021 and set at 55% since then. The withdrawal rate is intended to provide sufficient incentive to work. In addition, there will be a system of 'disregards' to enable some groups to earn varying amounts according to their circumstances before the taper starts to apply.

In calculating the amount of earnings to be taken into account in Universal Credit, 100% of contributions to an occupational or personal pension are disregarded.

2.2.2 Incapacity Benefit

Incapacity benefit continued for existing claimants whose disability or illness commenced before 27 October 2008, being replaced by the Employment and Support Allowance for new claimants (see 2.2.3).

Incapacity benefit can be short-term or long-term:

Short-Term Incapacity Benefit

Where there is no entitlement to SSP, incapacity benefit may be payable. This is in the form of short-term incapacity benefit and is payable at the lower rate (£104.85 per week – 2024/25 level) for a maximum of 28 weeks. This benefit is tax free. The higher rate of short-term incapacity benefit (£124.00 per week- 2024/25 level) is payable from week 29 to week 52. This is a potentially taxable benefit.

Higher amounts apply if the claimant is over State Pension Age.

Long -Term Incapacity Benefit

Long-term incapacity benefit is payable from week 53. This is a potentially taxable benefit and is £138.90 per week (2024/25 level).

In addition, if claimants were under age 45 when they first became unable to work they can claim an Incapacity Age Addition. An additional adult dependant's allowance is payable if the claimant's partner is over the age of 60 or the claimant has dependent children.

Incapacity benefit ceases on resumption of work or when the individual is considered capable of work.

2.2.3 Employment and Support Allowance (ESA)

Individuals who have limited capability to work because of an illness or disability, but who are not getting Statutory Sick Pay (SSP), may be able to claim the new-style (contribution-based) ESA. There is also an income-related ESA but the Universal Credit has replaced this for most people and no new claims are allowed. This benefit depends on a number of factors, including age and income circumstances.

Employees will usually receive SSP from their employer for the first 28 weeks of absence but may then qualify for ESA, which is paid by the Government. The contributory ESA is non-means-tested; to be eligible individuals must have paid enough NICs. They must undergo a Work Capability Assessment (WCA) by the DWP within the first 13 weeks of the claim to determine the extent to which their illness or disability prevents them from working.

At assessment, the DWP will place individuals into one of 2 groups if they are entitled to ESA:

1. the work-related activity group (for those that are able to get back into work in the future), entitled to up to £90.50 per week (2024/25 level);
2. the support group, entitled to up to £138.20 each week (2024/25 level)

It does not matter how old they are (although during the 13-week assessment periods, those under age 25 receive up to £71.70 per week (2024/25 level) otherwise the payment is up to £90.50 per week (2024/25 level)).

If the claimant gets an occupational or personal pension that pays more than £85 a week, the ESA payment will be reduced by half of the private pension income over the £85 limit.

2.2.4 Personal Independence Payment (PIP)

The Personal Independence Payment is for those under SPA who need extra help because of long term ill-health, a disability or mental health condition. It has replaced the Disability Living Allowance and is payable on top of ESA or other benefits regardless of income, whether NICs have been paid, or whether the claimant is working.

PIP is made up of two parts and eligibility for either or both depends on how severely the claimant is affected by the condition (figures are for 2024/25 level):

- the weekly rate for the daily living part of PIP is either £72.65 (standard) or £108.55 (enhanced).
- the weekly rate for the mobility part of PIP is either £28.70 (standard) or £75.75 (enhanced).

2.2.5 Industrial Injuries Disablement Benefit

Entitlement for this benefit is for those who have become disabled as a result of an accident or the contraction of a prescribed industrial disease during employment. It is not means tested and there is no consideration of the claimant's NICs record. The amount payable depends upon the extent of disablement as a consequence of the accident or prescribed disease. The maximum rate of benefit is £221.50 per week (2024/25 level).

2.2.6 Working Tax Credit

Working Tax Credit has been replaced by Universal Credit for most people. It is designed to boost the income of working people who are on a low income. The basic amount is up to £2,435 per annum (2024/25 level - made up of a number of elements depending upon the claimant's circumstances and depending on whether the claim is for a single person or a couple). The exact amount is calculated allowing for the claimant's circumstances using the online tax credits calculator.

2.2.7 Income Support

Income support has been replaced by the Universal Credit for most people. Its purpose is to top up the income of those whose income from all sources is below a minimum threshold level. It is only available for certain groups of people who do not get Jobseeker's Allowance or ESA and are not in full time employment.

The basic amount (2024/25 level) for a single person aged 16 to 24 is £71.70 per week, increasing at 25 (or at 18 if lone parent) to £90.50. Higher rates are payable for couples and claimants who are disabled.

2.2.8 The Benefit Cap

The Benefit cap is a limit on the total amount of benefits that working-age people (i.e. 16 to 64) can receive even if their full entitlement would otherwise be higher.

The level of the cap (2024/25 level) is £25,323.00 pa for those who live in a Greater London borough and

£ 22,020.00 pa for those living outside London; these amounts reduce to £ 16,967.00 pa and £ 14,753.00 pa respectively for single adults who don't have children living with them. Households may be exempt from the cap if they include somebody receiving certain benefits including Disability Living Allowance, Personal Independence Payment, Attendance Allowance, Working Tax Credit, or the earnings equivalent under Universal Credit.

Summary

Chapter 2 considered some of the benefits available to those who are unable to work because of sickness or disability and those with low incomes, payable by either their employer as statutory benefits or direct from the State, including:

- Statutory Sick Pay
- Universal Credit
- Employment and Support Allowance (replacing Incapacity Benefit)
- The Working Tax Credit
- Personal Independence Payment (Disability Living Allowance)
- Industrial Injuries Disablement Benefit
- Income Support
- Pension Credit.

It explored the structure and basic eligibility requirements of each benefit and the current payment rates; and looked at the Benefit Cap.

Self Test Questions

- After what period of sickness is Statutory Sick Pay applicable?
- On what date was the Employment and Support Allowance (ESA) introduced?
- What is the Working Tax Credit and who is it designed to help?
- What is the Benefit Cap?

CHAPTER 3

Automatic Enrolment

INTRODUCTION

This Chapter looks at employers' duties in relation to automatic enrolment, introduced in 2012 by the Pensions Act 2008. The background to this was concern about the ageing population in the UK, resulting in rising state pension costs. The new regime was introduced as a way of encouraging more people to save for retirement and targeted at individuals on low to moderate incomes.

Employers are required to automatically enrol workers who satisfy certain eligibility conditions into a qualifying scheme – this can be their own scheme, a personal pension scheme or a master trust such as the National Employment Savings Trust (NEST), which was set up by the government. The Pensions Regulator maintains a list of authorised master trust schemes that may be used for these purposes (see Part 4 section 2.3.2).

In 2017 the Government undertook a review of automatic enrolment, which found that the overall framework remains the right foundation but contained proposals that are expected to be implemented in the mid-2020s. These include lowering the age for auto-enrolment, from 22 to 18, and removing the lower earnings limit, so that contributions must be calculated from the first pound of earnings. The Pensions (Extension of Automatic Enrolment) Act 2023 is intended to enable legislation that could be in line with these proposals. The Government announced plans to consult in autumn 2023 on the implementation approach and timetable for the changes, but this did not happen; it is unclear what will happen to this initiative following the July 2024 general election.

The introduction of automatic enrolment has brought millions of people into workplace pension saving. However, it has also resulted in a rapid increase in the number of deferred small pension pots and this trend is expected to continue. In January 2023 the Government issued a call for evidence on addressing the challenge of deferred small pots, and a follow-up consultation explored next steps. The Government has confirmed that it plans to introduce a multiple default consolidator model to deal with the proliferation of deferred small pension pots. An industry delivery group was established in early 2024 to take the project forward. The aim was for the group to provide an interim update to Ministers by spring/summer 2024, with proposals for consideration in late 2024.

3.1 WHY AUTOMATIC ENROLMENT?

Automatic enrolment was seen as the best way to overcome evidence of inertia in people's savings decisions, the idea being that if employees are auto-enrolled into a suitable scheme, then most will not exercise their right to opt out. The measures aim to provide greater support for lower earners, to help them save for retirement. It was hoped that this would result in a significant increase in the number of individuals making provision for their retirement (and thereby reducing the requirement for future provision by the State).

3.2 THE AUTOMATIC ENROLMENT REQUIREMENTS

3.2.1 Automatic Enrolment

The main features are set out below.

- Broadly, all eligible jobholders (see below) 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 re-enrol eligible jobholders who have opted out, approximately every three years. This process of re-enrolment (see 3.2.4) means that employees who decide not to be in a pension scheme can only do so by repeatedly making a positive decision to opt out.
- 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 automatic enrolment duties were introduced in stages for existing employers, starting with larger employers. All employers that set up before 1 October 2017 were required to comply with the requirements on staging dates up to 1 February 2018. The duties now apply to all new employers from the date on which their first worker begins to be employed.
- Employers providing DB or hybrid qualifying scheme membership were able to defer their automatic enrolment obligations for certain existing jobholders at the employer's staging date until 1 October 2017, provided jobholders could opt into the scheme at any time during the period between the employer's staging date and 30 September 2017.

Assessing who is eligible

- 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 earnings are gross earnings, including sick pay and statutory maternity, paternity and adoption pay, between lower and upper thresholds. For 2024/25, qualifying earnings are earnings between £6,240 p.a. and £50,270 p.a. and the earnings trigger is £10,000 p.a. The gap between the earnings trigger and the lower qualifying earnings threshold is intended to prevent individuals earning just over the lower threshold being automatically enrolled and receiving very low benefits, and the associated administration for employers.

In 2017 the Government confirmed its intention to make changes in the mid-2020's that would reduce the lower age limit from 22 to 18, and calculate minimum contributions from the first pound earned (see the Introduction to this Chapter).

Scheme used for auto-enrolment and alternative requirements

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.
- Prior to the abolition of contracting-out on 6 April 2016, a DB scheme also satisfied the quality requirement where it related to jobholders in contracted-out employment.

For most existing pension schemes, the earnings definition for benefits (in the case of DB schemes) and for contributions (DB and DC) is not equal to qualifying earnings. For example, a DC scheme might base contributions on earnings excluding overtime; a DB scheme might base benefits on basic salary less an offset intended to take account of an assumed state pension.

For DC schemes, it was recognised that having a pensionable salary definition that differs from that for qualifying earnings could cause practical difficulties when trying to determine whether adequate contributions have been made. To address this, employers who provide a DC pension scheme have an alternative way of meeting the requirements - called certification - whereby they certify periodically that their scheme satisfies alternative quality requirements. These are based on the scheme's definition of pensionable salary, which is subject to a minimum of the individual's basic pay: the minimum contribution is 9% of pensionable pay where that is no less than basic pay (minimum 4% from the employer); OR if pensionable salary is no less than basic pay and, across all jobholders, constitutes at least 85% of total pay, the minimum is 8% (minimum 3% from the employer); OR if all earnings are pensionable, the minimum is 7% (minimum 3% from the employer).

From 1 April 2015, two alternative tests were introduced for a DB scheme to satisfy the qualifying criteria. One is based on the cost to the scheme of the future accrual of active members' benefits and the other is intended to allow DB schemes that satisfy certain conditions and that meet the minimum requirements for DC occupational schemes to be used for automatic enrolment.

3.2.2 Anti-avoidance

There are various anti-avoidance measures in place to prevent employers from only hiring those who have signalled their intent to opt out of the pension scheme or from giving inducements to jobholders to opt out.

There is provision in the 2008 Act for the Secretary of State to make regulations that prevent a pension scheme with an employee contribution rate that is set so high that it might discourage membership from being a qualifying scheme.

3.2.3 Minimum contributions for DC schemes

Where employers are using DC arrangements to satisfy their automatic enrolment duties, the minimum contribution requirement has been phased in. For the period between the employer's staging date and 5 April 2018 the minimum total contribution was 2% of qualifying earnings (with at least 1% coming from the employer); from 6 April 2018, the minimum rate was 5% (with at least 2% coming from the employer). From 6 April 2019 onwards, the minimum total contribution is 8% of qualifying earnings, of which at least 3% must be paid by the employer.

Employers may instead certify that their schemes meet the alternative minimum contribution requirements (see above).

3.2.4 Automatic Re-enrolment

From the point that the automatic enrolment duties apply to a particular employer, there may be some employees not in a qualifying scheme. Of these, some will be eligible jobholders who have opted out; others will be non-eligible jobholders or entitled workers who have not been automatically enrolled and who have not opted into a scheme.

These two groups are treated differently:

- eligible jobholders who have opted out are generally automatically re-enrolled on the next cyclical re- enrolment date. The first cyclical re-enrolment date will be a date chosen by the employer within 3 months either side of the third anniversary of the employer's staging date. Subsequent cyclical re-enrolment dates occur every 3 years on the anniversary date, also with a six-month window;
- non-eligible jobholders and entitled workers are not automatically enrolled unless they become eligible jobholders (for example, on reaching age 22 or earning above the earnings trigger), in which case they are automatically enrolled under the process described above; they can opt in to a scheme.

3.2.5 Restriction on Charges

Since April 2015, various charge controls have been introduced in defined contribution (DC) schemes (or sections of schemes), including:

- From April 2015, regulations made under the Pensions Act 2014 introduced a **charge cap** – this restricts the charges that can be levied on members' funds in a default arrangement in a DC qualifying scheme to 0.75% p.a. of funds under management. Some schemes do not have to operate a simple Annual Management Charge type structure – for example the initial charging structure used by NEST (see 3.3 below) combines a 0.3% AMC with a 1.8% charge on contributions paid in. Provided that the overall effect of such an arrangement is deemed to be broadly equivalent to the effect of an annual charge of 0.75% or lower, it will be acceptable. For this purpose, a default arrangement is any fund that members are put in if they do not express a preference and also any fund in which broadly 80% of members are invested where they do have to make a decision.
- Once an arrangement has become subject to the cap, the cap will continue to apply even if it subsequently ceases to satisfy the definition of a default. The FCA made equivalent rules to implement a charge cap on default funds for automatic enrolment in contract-based schemes.
- From April 2016, a ban applies to **member-borne charges or commission** in a DC qualifying scheme. This ban prevents charges from being levied on a member's funds to pay an adviser for services given to the member. The first phase of the ban applies to new charging arrangements or those which are varied or renewed after April 2016. The second phase of the ban, relating to arrangements entered into before 6 April 2016 was introduced from 1 October 2017.
- Members are able to opt out of either or both of the 0.75% charge cap or the ban on member-borne charges if they sign a written agreement that satisfies certain conditions. This will enable them for example to receive advice or a service such as one relating to the flexible drawdown provisions, and to pay for it by a deduction from their fund.
- Pensions Act 2014 regulations also ban so-called **active member discounts** in DC qualifying schemes from April 2016. An active member discount is usually a differential charging arrangement in a workplace scheme under which former employees suffer a higher level of charges than current employees.
- From the first charges year ending after 1 October 2021, certain **performance fees** could be ignored when calculating a charge under a single charge structure – however this was superseded by further changes introduced in 2023 (see below).
- From 6 April 2022 there is a **de minimis pot size of £100**, below which the flat fee element of a combination charge cannot be charged to members.
- From 6 April 2023 **specified performance-based fees** are excluded from the charge cap.

The Government carried out reviews of the DC charge cap on default funds in 2017 and 2020 but did not make any changes to the level and scope of the cap.

3.3 NEST

The automatic enrolment regime requires employers to automatically enrol workers who satisfy the earnings and age criteria into a qualifying scheme. For employers without their own pension scheme and for workers who do not qualify for entry into such a scheme, the employer may use the National Employment Savings Trust (NEST). Responsibility for running the scheme has been given to the NEST Corporation, a non-departmental public body reporting to the Secretary of State for Work and Pensions.

NEST is effectively a very large multi-employer occupational DC pension scheme. It is one of a number of master trusts. Employers participate in these centralised arrangements but do not actively appoint or remove trustees or have a role in the management of the scheme. Master trusts are covered in more detail in Part 4, Chapter 2. The Pension Schemes Act 2017 requires all master trusts to be authorised by TPR. NEST received this authorisation in 2019.

The intention is that the large scale of NEST will mean that the set-up costs can be spread over a long period and recovered from what eventually will be very large funds under management, thus resulting in a low average charge.

Although it is an occupational scheme, it shares the 'portability' characteristics of personal pensions in that individuals can keep their account as they change jobs and can continue to make contributions.

The stated aim is that NEST will complement, rather than compete with, existing high quality pension provision. To support this, initially there were limitations on transfers in and out of NEST (i.e. members were restricted in their ability to transfer a pension entitlement already built up in another pension scheme into their NEST account, or vice versa). There was also a maximum annual contribution allowable to a NEST account. For 2016/17, this maximum was £4,900. However from April 2017, the annual contribution limit was removed and at the same time, NEST removed certain other restrictions, primarily the restriction on receiving transfers from other arrangements.

3.3.1 Trustee body and legislative framework

NEST acts as a Trustee Corporation, with powers to manage the scheme. The trustee takes the key strategic decisions but delegates all executive and operational functions to a management board.

Pensions Act 2008 makes provision for scheme Orders to be made for NEST's establishment, administration and management. Subject to scheme Orders, further provisions about the scheme are made by Rules. Changes to the Order require the approval of Parliament as well as the consent of the trustees, who in turn must consult with the members' and employers' panels that are set up for this purpose. The NEST Rules can only be changed either by the trustees after consultation with the panels and other interested persons, or with the consent of the trustees.

3.3.2 Charges

NEST's charging structure is an annual management charge (AMC) of 0.3% of a member's fund, and a charge on contributions of 1.8%. The contribution charge was originally intended to persist until such time as the initial setting up costs have been recovered.

3.3.3 Employer and member participation in the scheme

NEST must accept any employer who wishes to use the scheme to fulfil their duty to automatically enrol employees into a workplace pension scheme. The scheme must also accept all the employees of those employers that are eligible to be automatically enrolled and those employees that are not eligible but opt in.

From 1 April 2017, NEST may also admit members transferred into the scheme as part of a without-consent bulk transfer of accrued rights. The employer must be a participating employer under NEST, but the members transferred need not be current employees.

The self-employed are permitted to opt into NEST.

NEST has published an employer set-up guide and its terms and conditions to which employers need to agree. The terms and conditions require the employer to provide the information NEST needs to administer the scheme and to pay contributions in accordance with an agreed payment schedule. The employer also agrees to provide (unspecified) information to members on behalf of NEST, but not after they have left the company. The terms and conditions also allow NEST to introduce charges levied on employers who incur additional costs by, for example, not paying contributions on time or not paying by direct debit.

3.3.4 Investment options

NEST's default options are called Retirement Date Funds (one for every year a member could choose to take their money out). For example, if a member wants to access their pension pot in 2040, their money is invested in the NEST 2040 Retirement Fund). The Retirement Date Funds invest in pooled funds and use a broad and diversified set of asset classes, and the investment objective for these funds. In addition to the NEST Retirement Date Funds, NEST provides a range of other fund choices.

3.3.5 Benefits

NEST is subject to the same decumulation rules as other pension schemes under Finance Act 2004. A lifetime annuity was believed likely to be the most appropriate product for most members. Members can also transfer their funds, for example to make use of other options, such as income drawdown.

Members buy an annuity at retirement through the open market. However, NEST has appointed a panel of providers who will offer a limited range of annuities for members. These providers must meet certain conditions, including:

- Enabling quotes to be provided in real time;
- Offering rates which are at least as competitive as identical products they offer on the open market;
- Providing annuities for pots of £1,500 and above.

3.4 WHAT AUTOMATIC ENROLMENT MEANS FOR EMPLOYEES

- Eligible jobholders (see 3.2.1) are automatically enrolled if they are not already in a qualifying scheme. This includes temporary and part-time employees.
- Other jobholders are able to opt into a qualifying scheme.
- DC arrangements are required to have minimum contributions of 8% of qualifying earnings, of which at least 3% are employer contributions. Contributions attract tax relief in the usual way.
- Alternatively, some employees are automatically enrolled into DB schemes.
- For low earners who may not otherwise be saving into a pension, there has been a concern that they will not get value for money from any contributions they make because of the potential impact on means- tested State benefits. This concern has been addressed partly by the application of the earnings trigger and partly by the decision to deliver a State pension from 2016 at a level above which most means-tested benefits are not payable (meaning that anything that an individual receives from private pension saving over and above the State pension is unlikely to impact significantly on any means-tested benefits).
- There has also been concern that those earning between the earnings trigger and the threshold for income tax could lose out on tax relief in schemes, such as occupational schemes, that give tax relief on net pay (with the pension contribution deducted before tax is calculated). Those saving via personal pensions do not lose out because tax relief is given at source. For more on this, see 3.8 in Part 4.

3.5 WHAT AUTOMATIC ENROLMENT MEANS FOR EMPLOYERS

Automatic enrolment has increased pension scheme take-up rates (i.e. the percentage of employees who participate in the scheme). The reasons for this are twofold:

- First, many more employees have been given access to a pension scheme to which their employer contributes. Previously, there was no legislative requirement for an employer to contribute to a pension scheme for any of its employees (in the past, employers were required to designate a stakeholder scheme but not to contribute it);
- Secondly, it is believed that many employees who would not have actively chosen to join a pension scheme have nevertheless remained in one when automatically enrolled.

However, working against this may be that some of the workforce, particularly young workers and low earners, feel that they cannot afford to make pension provision when they have other more immediate demands on their finances.

Although the take-up rates have increased generally, they vary from employer to employer, depending on various factors including the type of scheme provided and the demographic profile of its workforce.

Summary

Employer duties in relation to automatic enrolment were introduced by the Pensions Act 2008 with effect from 2012. The aim is to increase the numbers of individuals making their own retirement provision, particularly the lower paid. Master trusts such as NEST are simple, low charge products, as stakeholder schemes were intended to be when they were introduced with similar aims. However unlike the position for stakeholder schemes, where employers enrol jobholders, they must contribute.

Self Test Questions

- Why was automatic enrolment introduced?
- Which employees need to be automatically enrolled into a qualifying scheme?

Part 4

WORKPLACE PENSIONS

OVERVIEW

This Part deals with pension provision outside the State schemes or the legislative requirement for automatic enrolment.

Chapter 1 covers the different methods of providing workplace pensions schemes, occupational pension schemes (where an employer provides, and contributes to, a pension scheme for its employees), and also personal pensions, both those set up on an individual basis and those set up by companies on a group basis for their employees.

Chapter 2 looks at the different types of schemes, the common types of benefit design that they employ and how schemes are financed.

Chapter 3 concludes with an evaluation of what an employer might consider when selecting a trust, master trust or contract-based arrangement.

When you have completed this Part, you will understand what the different types of pension provision are outside the State schemes and will be able to give an outline of the principal characteristics of each type.

CHAPTER 1

Different Methods of Providing Workplace Pension Schemes

INTRODUCTION

Broadly, there are two main methods of providing workplace pension schemes in the UK: occupational pension schemes and personal pension schemes. Occupational pension schemes are established by an employer for the benefit of its employees. Personal pension schemes are individual arrangements entered into between an individual and an insurer.

Most occupational pension arrangements are established by the creation of a trust. A trust can be established by:

- a trust deed that is made between the employer and the initial trustees; or
- a declaration of trust by which the employer appoints itself as trustee.

However, most schemes are constituted by a trust deed and a set of rules (which sets out the benefits payable under the scheme and which is normally attached to the trust deed). In both cases the document will set out the terms of the trust.

Some pension arrangements are not set up as trusts. Unfunded schemes and retirement annuity contracts often take the form of a contractual arrangement or promise. Also, there are statutory occupational schemes for public sector employees which are set up by legislation and which do not take the form of a trust. Personal pension schemes can be set up under irrevocable trusts or, if the provider is an authorised insurance company or friendly society, can be established by deed poll.

The most common types of pension arrangement are examined in more detail below.

1.1 OCCUPATIONAL PENSION SCHEMES

An occupational pension scheme is (broadly) a scheme that is established by an employer to provide pensions and other ancillary benefits (e.g. death benefits) to its employees (and their spouses and dependants) and that is administered in the United Kingdom. This definition covers a wide range of pension schemes, including those governed by a letter between an employer and an employee, or a complex pension scheme that provides benefits to all of the employees in a corporate group.

Most occupational pension schemes are regulated by the requirements of the Pensions Act 1995, the Pensions Act 2004 and the Pension Schemes Act 1993. The Pensions Acts of 1995 and 2004 deal with matters such as funding and administration. The Pension Schemes Act 1993 deals with matters such as protection for early leavers (i.e. members who leave their scheme before normal retirement age and who do not take an immediate pension) as well as the requirements relating to schemes which were contracted out of the State second pension.

Occupational pension schemes are commonly described as either defined benefit (DB) schemes or defined contribution (DC) (which includes money purchase) schemes, depending on the type of benefits they provide. In the former, the amount of pension which the member receives is directly related to pay. For example, a member may receive 1/60th of final pensionable salary for each year of pensionable service. In the latter, the amount of pension reflects the contributions made to the scheme in respect of the member and the investment return on those contributions, which is then used to purchase an annuity from an insurance company. The most important difference between the two types of schemes is how they are funded and what this means for the burden of risk between the employer and the member. Under a DB scheme the majority of the risks relating to funding, investment and life expectancy are on the employer, whereas in a DC scheme the member bears these risks. Hybrid schemes provide both DB and DC benefits. Often these are provided by different sections of the scheme. A quite different type of hybrid scheme is one in which the benefit provided is itself hybrid in nature – for example, where the benefit is the best of a pension calculated on some formula and the proceeds of a money purchase pot.

In the past, an employee could not generally be a member of an occupational pension scheme if he was also contributing to a personal pension scheme. This position changed as a result of the Finance Act 2004. A person can now be a member of as many registered pension schemes (whether personal or occupational) as they like. There is however an annual limit on the total increase in the value of their pensions savings that will qualify for tax relief (and up to 5 April 2024 there was a lifetime limit; this lifetime allowance (LTA) has been removed from 6 April 2024, with limits now essentially applying only to the cash lump sums paid).

Occupational pension schemes are set up under trust, with trustees or managers appointed to run the scheme. Trustees are required to operate schemes in accordance with the scheme's trust deed and rules, and are also under a fiduciary duty to act in the best interests of members of the scheme. Trustees are responsible for appointing (in some cases) and holding to account (in all cases) those parties who are responsible for the day- to-day running of the scheme.

1.2 PERSONAL PENSION SCHEMES

A personal pension scheme is a pension scheme that is not an occupational pension scheme and which is established by a person with permission under the Financial Services and Markets Act 2000 to establish such a scheme. In practice, this means that personal pension schemes tend to be provided by insurance companies. To set up a personal pension scheme an individual will enter into a contract with the insurer.

This will set out the terms upon which the scheme will operate.

Many employers operate a group personal pension plan (GPP) for their employees. A GPP is essentially a collection of personal pension arrangements. An advantage of a GPP is that the employer can name the arrangement (e.g. the Colourboxx Group Personal Pension Plan), which can give it the feel of an occupational pension scheme. GPPs also tend to have lower administration charges.

Employers who offer a GPP or master trust for their workers may establish a management committee. A management committee is, like a board of occupational pension scheme trustees, comprised of a group of skilled and knowledgeable people who meet regularly to review the way a pension scheme is run and governed. In most cases there will be no contractual arrangement between the management committee and the pension provider, and the provider is not required to follow the management committee's proposals.

With effect from 6 April 2015, regulated firms operating workplace personal pension schemes (excluding individual personal pension schemes) are required to establish and maintain an Independent Governance Committee (IGC); providers with smaller and less complex workplace personal pension schemes are able to establish a Governance Advisory Arrangement (GAA), instead of an IGC. Although IGCs are established by firms they have a contractual duty to act independently of the firm and in the interests of relevant scheme members.

Like occupational pension schemes, personal pension schemes must be registered with HMRC in order to benefit from favourable tax treatment. A person may become a member of a personal pension scheme at any time.

1.2.1 Personal Pensions for Individuals

Personal pension schemes (personal pensions) were originally established as pension schemes that anyone could join to save for an income in retirement provided that they had 'relevant earnings' (broadly UK taxable earnings, with some exceptions) and provided that those earnings arose from non-pensionable employment. Personal pensions were introduced from 1 July 1988 to replace retirement annuity contracts. They all operate on a DC basis.

A personal pension can be established under irrevocable trust, by deed poll or, in Scotland, by a board resolution. A personal pension set up under trust may itself be under a master trust, or may consist of individual trusts for each member. To take advantage of the tax reliefs available, the personal pension must be a registered pension scheme'. Existing 'approved' personal pensions automatically became registered schemes on 6 April 2006.

Originally, personal pensions were meant to provide benefits on retirement, death or disability for the self- employed, and for employees who were not members of an occupational pension scheme. One consequence of this was that if someone was already a member of his company's occupational scheme, the only way that they could join a personal pension scheme was by leaving, or opting out of the company scheme.

Regrettably, some people took this course in the late 1980s or early 1990s in spite of the fact that by doing so they would normally cease to benefit from any employer contribution to their retirement provision (at the time, employers who sponsored an occupational pension scheme would normally not also contribute to a personal pension taken out by an employee). Where someone took such action relying on inadequate advice, their case had to be subsequently reviewed and often compensation was paid. This is often referred to as the 1980s pensions mis-selling scandal. Guidelines were produced for how to identify and compensate those who had received poor advice, and companies involved in sales of personal pensions were instructed to review relevant cases. Where the review identified that the person had been disadvantaged financially by opting out of an occupational scheme, or transferring their benefit entitlement out, the adviser had to offer to rectify the situation. This took the form of paying for the employee to be fully or partially reinstated into the employer's scheme or, if this was not possible, by paying a compensation payment into the personal pension scheme.

In 1991, the rules regarding simultaneous membership of occupational and personal pension schemes were relaxed, allowing most low and moderate earners to be a member of their company's occupational scheme and of a personal pension at the same time.

In April 2006 the restrictions on concurrent membership of pension schemes were removed completely and there is now no limit to the number or type of pension arrangements a person may be a member of.

1.2.2 Personal Pensions for Groups of Employees

Often an employer wanting to make pension provision for its employees will do so by using personal pensions. In this case, a group personal pension' (GPP) is usually the preferred vehicle.

A GPP is a collection of individual personal pensions that have been taken out with the same pension provider (normally an insurance company) and which were taken out for the employees of one particular company or group of companies. The benefits of scale, and in particular efficiencies on the sales and marketing side, mean that the terms offered by GPPs will often be better than those that could be obtained by employees setting up personal pensions on an individual basis through a financial adviser.

Historically it has been quite common for the enhanced terms to only be available while the member is an employee of one of the companies participating in the GPP – a so-called active member discount. However from April 2016 this practice has not been allowed in relation to qualifying schemes used for automatic enrolment (see Part 3 Chapter 3).

Usually, the employer will contribute to the GPP and these contributions will normally be deductible against corporation tax. While a GPP is not an occupational pension scheme, it shares some of the characteristics of one. In particular, the GPP can often be branded with the company's name and logo and, to the member, it appears much like an occupational money purchase scheme.

Unlike most occupational schemes, contributions made by members are made from net earnings. Members' contributions are then grossed up in respect of basic rate tax by the pension provider. In other words, every £80 actually contributed by the member is grossed up to £100 by the provider (based on the 2024/25 basic tax rate of 20%). The provider then reclaims this tax from HMRC. This is known as relief at source (RAS).

Higher and additional rate taxpayers can claim further tax relief either through their tax assessment or by writing to HMRC to request an adjustment to their tax code.

Note that this tax treatment differs from that which applies to most occupational pension schemes. In the case of these arrangements, members' contributions are usually made from gross earnings and are offset against the member's taxable earnings. So a member wishing to make a gross contribution of £100 would have this amount paid from their salary and their income tax liability would be based on the residual earnings. This is known as the net pay arrangement.

Although almost all occupational schemes use the net pay method, this is not a requirement. NEST is an exception in being a trust-based occupational scheme that operates on a relief at source basis. All personal pensions (including GPPs) are required to use relief at source.

Low earners can have different levels of take-home pay depending on whether their pension scheme is administered using RAS or the net pay method – see 3.8 for more on tax relief for low earners.

1.2.3 Self-Invested Personal Pensions (SIPPs) and Income Drawdown

SIPPs were introduced following a government initiative announced in the 1989 Budget, which was intended to make it easier for members of personal pensions to control their own pension fund investment.

SIPPs received a further boost to their popularity from the 1995 Finance Act which introduced income drawdown.

As introduced, income drawdown, or income withdrawal, was a facility whereby a member, who wants to start taking benefits but does not want to buy an annuity, could defer the purchase of an annuity and, in the meantime, take an income from the fund which can vary from year to year. Before the new pension flexibilities were introduced with effect from 6 April 2015, there were two types of drawdown provided for in the tax legislation:

Under capped drawdown, the maximum amount of income that could be taken in any year is limited by regulations that are designed to ensure that the member does not run down his funds too quickly. However, there was no minimum amount that must be taken, and any funds that are not drawn remain invested to benefit the member in later years.

Alternatively, provided that the member satisfied the 'minimum income requirement' and certain other conditions, he could take flexible drawdown. In this case there was no maximum amount that could be taken in any year - so for example the member could take the entire fund in one (taxed) lump sum.

In order to satisfy the minimum income requirement, the member had to have had other pension income of at least £20,000 p.a. (reduced to £12,000 from 27 March 2014). Pension income that can be counted for this purpose included most scheme pensions, annuities and State pensions.

Although income drawdown was initially very much associated with SIPPs it became increasingly common for it to be offered by other types of pension arrangements, including conventional personal pensions and even some stakeholder pensions. Many more DC arrangements have started to provide income drawdown following the introduction of the new flexibilities.

A SIPP works in much the same way as a normal personal pension plan. Contributions are paid in the form of regular or single contributions. Transfers can be paid to or accepted from other registered pension schemes.

A SIPP might appeal to someone who wishes to control their own investment strategy using the greater investment freedom that a SIPP offers. Although the member has the right to direct the investment strategy the Scheme Administrator will decide which investments are to be permitted in the SIPP.

A SIPP is often used by a partnership or a sole trader to buy a commercial property. Often the rent will cover both the interest payments and capital repayment. The whole of the rent will usually qualify for tax relief for the trading entity.

One regrettable consequence of the rise in popularity of SIPPs and the investment freedom that they offer has been the use of fraudulent arrangements that have apparently been set up as SIPPs but are actually vehicles used for pension scams. There are two ways in which this can happen: One is that an arrangement is established which describes itself as a SIPP in order to accept a transfer of a member's pension pot from a bona fide pension scheme. However, once the transfer has been received, the receiving arrangement pays out the money in a way which would not be authorised under the Finance Act 2004, exposing the member to large unauthorised payments charges in addition to any fees charged by the arranger, which are typically themselves large amounts. The other way is that the arrangement does indeed qualify as a SIPP, but the arranger then uses the ability of the member to direct investments to make an inappropriate or even fraudulent investment, again often deducting large fees. Administrators of genuine pension schemes work hard to spot such pension scams and where possible avoid complying with a members' requests to pay transfer values to them; however in spite of their best efforts, they have not always been successful.

1.2.4 Authorised Provider

Only an authorised pension provider, as defined by the FCA, may establish a personal pension. These are likely to be insurance companies, building societies, banks, unit trusts and friendly societies.

1.2.5 Payment of Personal Pension Providers

The way providers receive income will differ with the type of provider. Charges are usually taken in the following ways:

- **Insurance companies** - from the premiums paid into their products or the money invested in their funds.
- **Building Societies and Banks** - from the difference between the interest they earn and the interest they pay.
- **Unit Trusts** - from the bid/offer spread.
- **Friendly Societies** - as for insurance companies.

Other costs will be levied by other advisers. For example, financial advisers may be paid by hourly rates, a percentage of the customer's investment a fixed fee plus annual review fee (but not commission, which has been banned since 1 January 2013 following the Retail Distribution Review).

1.2.6 Retirement Annuities

The retirement annuity was the forerunner to the personal pension. No new retirement annuity contracts have been permitted from 1 July 1988, although contributions to existing policies were allowed to continue, and many such contracts are still in existence.

Historically, retirement annuity contracts (sometimes also referred to as section 226 policies) were set up by insurance companies principally for the self-employed. There were differences between the rules governing personal pensions and retirement annuities, including the following:

- the tax treatment meant that employers did not contribute to retirement annuities direct;
- retirement annuities were set up with a minimum retirement age of 60, whereas personal pension benefits could usually be taken from age 50 (increased to 55 from 2010);
- the amount that could be taken as a tax-free cash sum at retirement was calculated differently.

1.2.7 Stakeholder Pensions

A stakeholder pension scheme is essentially a personal pension scheme that satisfies certain minimum standards, including:

- A limit on annual management charges – these must not exceed 1.5% of the fund's total value during the plan's first ten years; after this, the charge may not exceed 1% of the total fund (but if an employer is using a stakeholder pension to meet its automatic enrolment duties there will be a charge cap of 0.75%).
- It must accept transfers in from other registered pension schemes and no charge may be made for transfers to other stakeholders.
- A stakeholder provider can stipulate a minimum contribution as long as it is no higher than £20.
- There must be a default investment option.

From 8 October 2001, every employer with five or more employees which did not provide an occupational pension scheme for its employees nor contribute at least 3% of earnings to a GPP, had to designate a stakeholder pension scheme for its employees and make arrangements for any employee who wished to contribute to have their contributions deducted from their pay and remitted to the scheme provider.

Employees did not have to join the pension scheme and employers did not have to contribute. Research has shown that most stakeholder schemes were empty shells in the sense that although the employer had designated a scheme and offered access to it, no employees have actually joined and so no contributions had been made.

As a result of the introduction of the employer's automatic enrolment duty (see Part 3, Chapter 3) the stakeholder requirement was abolished from 1 October 2012 in relation to new members. However existing members must be allowed to remain in the scheme; and where employees were already contributing to a stakeholder, the employer remains under an obligation to continue deducting contributions and remitting them to the provider until such time as the employee leaves or choses to stop payment.

1.2.8 Master Trusts

Master trusts are usually trust-based DC occupational pension schemes for non-associated employers, designed to be used in the same way as group personal pensions. However the Pension Schemes Act 2017 introduces a broad definition that also encompasses schemes that are not run as commercial enterprises and which have not generally been thought of as master trusts (for example industry-wide schemes).

For more on master trusts see 2.3.2.

Comparison with GPPs

From the point of view of employers, particularly those with a high turnover of staff, one advantage that master trusts have 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. However 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. Other advantages include the relative flexibility in member communications compared with GPPs.

From the point of view of providers, historically the relatively light regulatory framework made establishing and operating a master trust attractive compared to the more heavily regulated personal pension regime. However, since 2018 all master trusts must be authorised and supervised by the Pensions Regulator (see 2.3.2).

Summary

Personal pensions can be set up on a group or individual basis. They include stakeholders and SIPPs. They replaced retirement annuities and were originally for those who were in non-pensionable employment. Now anyone can take out a personal pension.

Stakeholders are a particular type of personal pension satisfying certain criteria, principally what historically were regarded as low charges and acceptance of small contributions. Unless exempted, between 2001 and the introduction of automatic enrolment in 2012, employers with five or more employees had to designate a stakeholder scheme and facilitate membership for any of its employees who want to join. However, there was never any requirement for employees to join and if they did, no requirement for employers to contribute.

SIPPs offer more flexibility of investment and almost always offer an income drawdown facility (although this is not unique to SIPPs). Only authorised providers can establish a personal pension by deed poll (or board resolution).

Self Test Questions

- What is the difference between group and individual personal pensions and the circumstances in which each might be used?
- Outline the mechanism whereby an individual benefits from the tax relief given to contributions paid to a personal pension and explain how this differs from a member contributing to an occupational scheme.
- Why might an individual set up a SIPP and what are the investment restrictions that apply?
- What are the similarities and differences between personal pensions and retirement annuities?
- What are the main features of a stakeholder pension?
- What are the employer access requirements that relate to stakeholder pensions?

CHAPTER 2

Different Types of Benefit Design and Types of Workplace Pension Schemes

INTRODUCTION

Broadly, there are two main methods of providing workplace pension schemes in the UK: This Chapter examines the different benefit structures found in workplace pension schemes. It describes the two most common structures, which are the DB design (including final salary or average salary schemes) and the DC design (which is also referred to as money purchase). It covers hybrid schemes, which provide benefits on both DC and DB bases; and goes on to describe the different types of workplace pension scheme that you might expect to encounter.

2.1 BENEFIT STRUCTURES FOUND IN WORKPLACE PENSION SCHEMES

2.1.1 Defined Benefit Pensions

DB arrangements are always occupational schemes. The term defined benefit means that the pension provided is calculated by reference to a formula set out in the scheme's rules, rather than being directly related to the amount of contributions paid or the investment performance of the assets held in the scheme's fund. There are two types of DB arrangement commonly used in the UK: final salary and career average.

Funding DB schemes

Generally in a DB scheme of whatever type, members contribute at a fixed rate. The contribution rate is set out in the scheme's rules. However, although the rate at which benefits accrue is known in advance, the ultimate cost of providing them is not. The employer's contribution rate is variable, and is determined by an actuary on a periodic basis. Although the contribution rate is variable, typically the ongoing rate is significantly higher than that paid by members with this difference often being greatly magnified when deficit reduction contributions (which are paid by the employer when the scheme is underfunded) are taken into account.

Pension Schemes Act 2021

In 2018 the Government published a white paper on protecting defined benefit pension schemes, setting out its approach for the future of the DB system. This led to the introduction of the Pension Schemes Act 2021. Among other things, for DB schemes the Act strengthens the Pensions Regulator's powers and requires a statement from trustees on their funding and investment strategy (these provisions have now been put into effect, for valuations with effective dates on or after 22 September 2024).

DB consolidation - superfunds

The white paper considered DB commercial consolidators and later that year, the DWP consulted on a legislative framework for authorising and regulating such so-called superfunds. In July 2023 the government issued a response to that consultation which sets out the key features of its proposed regime, noting that it would bring forward primary legislation "as soon as parliamentary time allows" to provide for a new compulsory framework, with further detail to be set out in secondary legislation.

The Pensions Regulator would be responsible for authorising and supervising superfunds and in June 2020 it issued its own guidance, setting out how it would regulate such schemes until future legislation is put in place. In October 2020 the Regulator followed this with guidance for trustees and employers considering transferring DB scheme liabilities to a superfund. In November 2021 it named Clara-Pensions as the first DB superfund to meet its standards of governance and administration, as part of the interim regime for DB consolidation. In August 2023 it reviewed its guidance both for those setting up and running superfunds and for ceding trustees and employers.

The corporate plan for 2024-27 indicates that it is working with the DWP on potential legislation for superfunds and that it will assess alternative models as they emerge.

2.1.2 Final Salary Schemes

This has been historically the more common type of design (although in recent years career average schemes have grown in popularity). Such has been its dominance in the past that it is sometimes mistakenly believed that the terms final salary and defined benefit are essentially synonymous.

The amount of pension provided on retirement is calculated by reference to a formula:

***Pension** = N x Accrual Rate x Final Pensionable Salary*

Where:

N is the length of time that the member has been a member of the scheme, and is usually described as Pensionable Service

The **accrual rate** is a fraction - commonly sixtieths or eightieths or hundredths – or a percentage say 1.5%

Final Pensionable Salary (FPS) is based on the member's salary at the time the member leaves the scheme. The exact definition varies from scheme to scheme, but common definitions are based on basic earnings as at a specified date in the preceding year or an average of basic salary over the final 12 or 36 months of scheme membership. In some cases, part of basic earnings may be omitted from the definition of FPS. For example, an amount equal to the Lower Earnings Limit (LEL) may be disregarded. It should also be noted that gross earnings, which may vary from year to year due to bonuses and overtime, are sometimes used to calculate FPS.

In the case of a member who leaves a 60th accrual scheme after 30 years' membership with an FPS of £30,000, the benefit calculation will be:
Pension = 30 / 60 x £30,000 = £15,000 p.a.

2.1.3 Career Average Revalued Earnings

Career Average Revalued Earnings (CARE) schemes are an increasingly popular alternative to final salary schemes. Major examples in the private sector have included the schemes sponsored by Tesco and the Co- Operative Group (and following the Hutton review and the Public Services Pensions Act 2013, most public sector pension provision will be made through CARE schemes in the future). The principal difference when compared to a final salary arrangement is that benefits reflect earnings throughout the period of membership rather than just in the period preceding the date of exit. A typical design is summarised below. The example arbitrarily uses an accrual rate (see above) 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.

The appeal to employers of this design compared with a final salary alternative is that it remains possible to offer a DB scheme whilst maintaining a measure of predictability and so more control over costs. This is because in a final salary scheme the accrued liability in relation to any member is difficult to ascertain with certainty as it depends on future earnings received in the period prior to the date of leaving or retiring (a date that is difficult to predict). Furthermore it is difficult for the scheme to make investments that are expected to match future earnings growth with any certainty. In contrast in a CARE scheme, the liability that has accrued will usually increase in line with price inflation and will not depend on the date the member leaves the scheme. In addition, finding investments that are expected to match or exceed inflation-linked liabilities is in theory relatively straightforward.

A CARE scheme design may also be suitable if the employees have varying earnings patterns due to changes in working hours or bonuses and overtime over their period of membership. For example, the remuneration of some manual workers may have a significant element of overtime which often decreases with age. In this situation, effectively averaging the remuneration over the working lifetime may be preferable.

It can also be argued that CARE schemes have become more appropriate relative to final salary schemes as the number of jobs that individuals can expect to have over their working lifetime has increased. This is because changing jobs tends to have more effect on the benefit provided by a final salary scheme then it does under a CARE scheme.

This results from the fact that under a final salary scheme, each year's accrual increases to retirement in line with the individual's salary if he remains with that employer and in line with price inflation if he does not. Over a long period, there can be quite a significant difference. Compare with a CARE scheme, where each year's accrual will be increased to retirement date in line with inflation irrespective of when the individual leaves the employer.

2.1.4 Defined Contribution Pensions

Pension schemes established on a DC basis are also referred to as money purchase arrangements. However the term money purchase scheme is defined in some statutes so caution must be exercised when using either term as depending on the context they are not always interchangeable.

A DC pension arrangement determines a member's ultimate retirement benefits by reference to a certain level of contributions paid into the arrangement by and/or on behalf of the member, which are then usually increased by an amount based on the investment rates of return achieved on those contributions over a period of time, thus establishing a fund with which to provide benefits. In other words, what the member gets at retirement depends on the size of their fund at retirement. The fund can increase or decrease depending on market conditions and it is not possible for the member to know in advance what the overall return on the fund will be (and hence the size of the fund at retirement).

Furthermore, in the past at retirement most of the fund will need to be converted into income. Historically, this has usually been done by purchasing an annuity. As this will usually depend on the annuity rates available at the member's retirement date, this represents another area of uncertainty for the member.

Historically therefore, scheme designs have included default lifestyle to mitigate this risk (see below).

The funding characteristics of a DC scheme are the exact opposite of those for a DB scheme. Because contribution rates for members and the employer are set out in the rules, the cost of running the scheme can be easily predicted. However, the amount of pension that will ultimately be paid to the member will be subject to a range of variables such as:

- The period of time over which contributions are paid
- Investment growth within the fund
- The timing of the member's retirement
- Where an annuity is chosen, annuity rates (the conversion factor used to determine the rate of income to be provided by the member's fund) at the time of retirement

This means that although the cost of the scheme is known in advance, the amount of benefit provided is not.

The most common solution to the problem of volatility in asset values and annuity costs close to retirement has been the use of lifestyle funds. These attempt to gradually switch the member's account into a mix of assets that matches the type of benefits expected to be paid out. For example, if you assume that the member will use 75% of their funds to purchase an annuity at age 65, then the aim might be to gradually switch 75% of the funds into long-dated bonds over the 5-10 year period prior to age 65. The idea is that, while this type of investment might not be expected to give the highest return over the long term, changes in its value near retirement should match changes in annuity prices.

Any changes to the expected retirement date in the 5 to 10 year period before that date, or to the form in which benefits will ultimately be taken (e.g. drawdown or annuity) may undermine the lifestyle strategy.

From April 2015, it is expected that many more members will decide at retirement not to buy an annuity but instead use the new pension flexibilities to access some or all of their pension in the form of a lump sum, which can be done at any time from age 55.

Examples of DC pension arrangements can include personal pension plans, stakeholder pensions, occupational money purchase schemes; and master trusts (including NEST).

2.1.5 Cash Balance Schemes

Some employers in the UK have turned to cash balance plans. Although cash balance schemes are DB schemes, they share some characteristics of money purchase schemes. Like money purchase schemes, contributions are paid each year by the employee and employer, are invested, and at retirement the member is provided with a cash sum which is then used to provide a pension.

However unlike money purchase schemes, the cash sum at retirement is defined at the outset, and does not depend on investment returns. The employer will pay in whatever level of contributions is necessary to provide this lump sum.

For example, a company might set up a cash balance scheme where members pay 5% of salary each year and in return get a lump sum at age 65 of 20% of final salary for each year of membership. So a member with ten years' service when he reaches age 65 will have a pot equal to twice his final salary, and will use this to buy a pension (although in common with other schemes, part of the benefit can usually be taken in the form of a lump sum).

Alternatively, the rules might set out what the employer's minimum contribution rate is and also stipulate a rate of investment return to be allocated, for example 7% p.a.. This alternative cash balance structure is

also DB, because it is possible to work out in advance what benefit (expressed in cash terms) the member will get for a given number of years' service and for a given salary.

In either case, the sum of money available to provide benefits for the member at retirement is calculated in accordance with a formula. This is fundamentally different from a money purchase arrangement, where the fund at retirement depends on the investment returns actually earned, and cannot be known in advance.

However, although 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.

2.1.6 Hybrid Schemes

A hybrid scheme is an occupational pension scheme that offers both DC (money purchase) and DB (final salary or CARE) benefits. It may also be referred to as a mixed benefit scheme.

DB schemes that provide AVC benefits on a DC basis are technically hybrid schemes, but in most contexts this type of scheme would not be described as such.

With the decline in DB benefit provision, a common type of hybrid scheme is one that has a DB section that is closed to new entrants with all new members after a certain date being put into a separate DC section of the scheme. It would then not be uncommon in time for the original DB section to be made paid up, i.e. no further benefits are accrued under it, with all benefit accrual after a certain date being provided on a money purchase basis in the DC section.

Alternatively, a hybrid scheme can be one where the benefits are calculated as the better of two alternatives, perhaps comparing the benefits available on a DC basis to those available on a DB basis. One example would be a scheme that offers DC benefits funded by an annual member contribution of 5% of salary, and an employer contribution of 10% of salary, but with an 80ths underpin – in other words, the members would receive the proceeds of their DC pot but with a guarantee of a pension of at least 1/80th of pensionable salary for each year of service.

Care is needed not to confuse DB/DC underpin schemes with schemes that have separate DC and DB sections. These types of arrangement are quite different in character, although the term hybrid might be used to refer to either.

2.2 PRINCIPAL RISK CHARACTERISTICS OF PENSION SCHEMES

There are a number of types of risk associated with pension schemes.

In DC schemes, the main risk is that the eventual benefit will be less than the benefit the member had been expecting, either due to poor investment performance or because of an increased price of annuities at the time of retirement. This risk is borne by the member, in the sense that it is the member who stands to lose if investment performance is poor, annuities expensive or he outlives his fund.

2.2.1 De-risking Strategies

Some examples of de-risking strategies are outlined below

- **Insurance type solutions**
  In a buy-out or buy-in, liabilities are either taken on by an insurance company or kept within the scheme but 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**
  In an 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. In a pension increase exchange exercise, pensioners are offered a one-off increase to their pensions in exchange for giving up their rights to receive certain pension increases in the future.

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

2.2.2 Collective defined contribution schemes

The Pension Schemes Act 2021 sets out the framework for 'collective money purchase schemes', commonly referred to as collective defined contribution (CDC) schemes.

From 1 August 2022, CDC schemes became available as a new option for pension provision, for single employers or groups of connected employers. In April 2023 TPR announced its authorisation of the first CDC scheme – the Royal Mail Collective Pension Plan.

CDC schemes pool risks and costs between members, rather than each member having their own individual pot. They offer a targeted – but not guaranteed – level of income in retirement, with the flexibility to adjust benefits if circumstances require. The employer benefits from fixed-cost defined contributions and is not required to pay additional contributions to ensure that the funding for a level of benefits remains on target.

The Pensions Regulator's code of practice on the authorisation and supervision of CDC schemes came into effect on 1 August 2022. The necessary criteria to be authorised include, for example, that the trustees and others involved in the scheme are fit and proper, and that the scheme is financially sustainable. For ongoing supervision, trustees may be asked to submit a supervisory return no more than once a year; and the Regulator must be notified of significant events that might affect the scheme's ability to continue meeting the authorisation criteria.

Following its earlier consultation on policy options, the DWP was expected to consult in autumn 2023 on draft regulations to extend CDC to whole-life multi-employer schemes. It has also committed to creating provision for decumulation-only CDC products, and exploring how these products could operate in the best interests of members, but did not set a timescale for these actions. It is unclear what will happen to these initiatives following the July 2024 general election.

2.3 TYPES OF WORKPLACE PENSION SCHEMES

2.3.1 Public and Private Sector Pensions

Types of Public Sector Schemes

A public service pension scheme is a statutory occupational scheme that 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.

Public sector schemes, for employees of the State and its agencies, include some of the oldest and some of the largest group schemes such as the Principal Civil Service Scheme, the Police Pension Scheme and the Firemen's Pension Scheme. They are divided into:

- Statutory schemes, which are constituted by statutory powers (an Act of Parliament, a Statutory Order or a Statutory Instrument).
- Non-statutory schemes, which are constituted by a trust deed and rules and conform with normal HMRC requirements, for example, the trust-based Universities Superannuation Scheme.

Features of Public Sector Schemes

Summarised below are the common features of Public Sector schemes prior to the changes introduced by the Public Services Pensions Act 2013.

- 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.

Public Sector Pensions Reform

Following the recommendations of the Hutton review of public sector pensions, the Public Services Pension Act 2013 introduced changes to schemes across the sector. The main provisions of the Act are:

- The main existing public service schemes may not provide benefits in relation to service after 31 March 2015 (or service after 31 March 2014 for the Local Government Pension Scheme)
- For regulations to be made to establish new schemes; most are CARE schemes
- In general, normal pension age will be linked to State Pension Age, with some exceptions for members of the police, fire fighters and armed forces
- A cost control mechanism will keep the ongoing cost to the employer of the schemes, when measured as a percentage of pensionable salaries, within defined margins

The Government also moved away from using the RPI as the inflation measure on which public sector pension increases are based, employing instead the Consumer Prices Index (CPI). For technical reasons, in the long term the CPI is expected to increase at a somewhat slower rate than the RPI.

The Act also introduced the framework for the governance and administration of public service pension schemes and provided an extended regulatory oversight by the Pensions Regulator. Prior to this, the Regulator had very little responsibility in relation to the oversight of public service pension schemes. The Regulator issued code of practice no. 14 on the governance and administration of public service pension schemes (now part of the Regulator's general code of practice, see 1.1.2).

Private Sector

Private sector occupational pension schemes are usually not governed by special statutes; they are generally established by trust.

While public sector schemes include some of the oldest and some of the largest group schemes, the greatest number of schemes are in the private sector. According to the Office of National Statistics' 'Pension Trends' survey, in 2011 (so before automatic enrolment had started) there were 8.2m individuals actively accruing benefits in occupational pension schemes (this does not include other workplace pension schemes such as Group Personal Pensions or Stakeholder schemes). Of these, some 2.9m were in the private sector. The numbers, particularly those relating to private sector DC schemes, have since been swelled by the roll out of automatic enrolment.

Private sector schemes may be of DB, DC or hybrid design. They may cater for entire workforces or groups of employees (such as those at one site, or the executives of the company). They may provide benefits to the employees of one company, two or more related companies or groups of unrelated employers.

Design of Private Sector Schemes

Private sector scheme sponsors have considerable freedom over scheme design. However there are legal constraints, including:

- pensions tax legislation (principally the Finance Act 2004)
- DWP pensions legislation (for example the Pensions Acts)

- other non-pensions UK and EU law, such as general trust or contract law, employment law, anti- discrimination law etc.

Where legal constraints exist that might be restricting the introduction of novel scheme designs, these were considered by the Government as part of its strategy for reinvigorating pension schemes, which considered the introduction of defined ambition schemes (see 2.2.2).

There are other considerations, such as:

- Should members contribute (contributory) or not (non-contributory)?
- What Normal Retirement Age should be adopted?
- If the scheme is not being used to comply with the employer's auto-enrolment duties (see Chapter 3 of Part 3) then questions include: Who should be eligible to join and when? Some may decide that employees should join immediately they are employed, others may specify a waiting period or other eligibility condition (such as a minimum or maximum age). Even when the auto-enrolment requirements do apply, some of these types of questions are still relevant, since:

  (i) the employer can always be more generous that is required by legislation (e.g. allowing in employees who are not eligible for auto-enrolment); and

  (ii) it may be that the employer is not using the scheme in question for automatic enrolment (a different arrangement could be being used for compliance with the employer's statutory duties).
- Should benefits be uniform or varied by category of membership (for example, executives or senior staff, or salespeople or other groups of employees)?

From April 2015 DC schemes have been able to offer their memberships even more flexibility in terms of options at the decumulation stage (i.e. when members start to take benefits from their funds, as opposed to the accumulation stage, where they are building up their funds by contributions and investment returns).

Whatever design features it adopts, the employer can distinguish between groups of members. One scheme, for example, could have:

- a 'works' category, which provides money purchase benefits, where the members pay 2%, the employer pays 5% and the retirement age is 65;
- a 'staff ' category, which provides a contracted in final salary benefit with an n/60ths accrual rate, a 5% employee contribution rate and a retirement age of 65;
- an 'executives' category, which provides a contracted in final salary benefit with a higher accrual rate (such as n/30ths), no employee contributions and a retirement age of 60;
- provide executives with a top up benefit using a separate Executive Pension Plan;
- use one scheme for employees who satisfy specified eligibility criteria and who have actively applied to join it, with a different scheme being used to auto-enrol other eligible jobholders (see Part 3, Chapter 3).

The Colourboxx pensions arrangements provide an example of how a company's pension design might have changed over the years.

The Colourboxx final salary plan was established in 1962 and is now only open by invitation to senior staff. The scheme structure is fairly typical of final salary schemes established around that time but has proved to be a significant expense for the company. In common with many final salary schemes it is currently in deficit

The Colourboxx money purchase plan was established in 2004 and has matched employer and employee contributions. The design of this scheme clearly has cost containment as a key issue, whilst retaining the paternalistic desire of the company to provide retirement and death benefits for its employees.

The Colourboxx Cosmetics Retirement Benefits Scheme is scheme that had been set up by a company that Colourboxx bought in 1997 and which is now being run as a closed scheme.

The Colourboxx Stakeholder Pension Plan is a Stakeholder arrangement for the employees and former employees of various small companies which have been acquired by Colourboxx and which had offered their employees personal pension schemes.

2.3.2 Master Trusts

A master trust is a multi-employer trust-based pension scheme under which each participating employer has its own, effectively ring fenced, section. Benefits are usually provided on a DC basis. There is a single professional trustee board that is responsible for administering the scheme, selecting service providers and selecting the range of investment options, while each participating employer determines the eligibility criteria and contribution rates for its section. Master trusts therefore offer a trust-based structure with some of the benefits of a contract- based scheme in terms of cost savings and a reduced administrative burden for employers.

The numbers of commercial master trusts grew considerably following the introduction of automatic enrolment, and this was the cause of some concern. Although the regulatory regime for master trusts was broadly the same as any other trust-based DC occupational pension scheme, there was broad consensus that the regulatory controls were insufficient to provide appropriate levels of assurance to master trust scheme members. Therefore, the Pension Schemes Act 2017 created a new authorisation and supervisory regime for master trust schemes from 1 October 2018.

For these purposes, a master trust scheme is broadly defined as an occupational pension scheme that provides money purchase benefits and is used, or intended to be used, by two or more employers (that are not connected with each other). The associated regulations include further exclusions, including where the only money purchase benefits relate to AVCs or transfers-in. As well as including industry-wide schemes in the definition, the government has extended the regime to other schemes that it believes pose similar risks to beneficiaries.

The Regulator has published code of practice no. 15 on the authorisation and supervision of master trusts, as well as issuing supporting guidance and its supervision and enforcement policy.

From October 2018 existing master trust schemes had a six-month window to apply to the Pensions Regulator for authorisation, or to decide to wind up the scheme. The Regulator maintains an online list of the schemes that have been authorised.

2.3.3 EU Pensions Directives and Cross-border schemes

The 2013 pensions directive is also sometimes known as IORP, because its correct title is the Directive on the Activities and Supervision of Institutions for Occupational Retirement Provision. An EU directive is a legal instrument that lays down principles which member states must implement through their own domestic legislation (though in certain circumstances provisions of a directive may have direct effect, i.e. apply in a member state even though no domestic legislation is in place).

A revised pensions directive, sometimes known as IORP II, came into force in January 2017 and member states had until 13 January 2019 to implement the provisions into national law. These included revised cross-border requirements, mainly concerning cross-border transfers. In the UK, regulations to implement those provisions came into force on 13 January 2019.

The UK's exit from the EU, and the end of the transition period on 31 December 2020, means that the pensions Directive does not apply to the UK. However, many of the requirements were incorporated into UK legislation while the UK remained a member state.

Cross-border schemes

A cross-border scheme is a scheme that is designed to allow cross-border activity. Prior to Brexit, a UK cross-border scheme referred to a UK-based scheme that accepted contributions from an EEA employer in relation to employees in that EEA country. The EEA consists of the EU member states, plus Iceland, Norway and Liechtenstein.

Between 23 September 2005 and 31 December 2020, UK legislation was in force that implemented the requirements of the original IORP Directive in relation to cross-border activity. In relation to UK-based schemes, this meant operating a scheme in the UK (the home state) where the relationship between the employer and employees was subject to social and labour law of a different state (the host state). UK legislation prevented scheme trustees receiving contributions from a European Employer unless they were authorised and approved by the Pensions Regulator. From 1 January 2021 that legislation – including any requirement for authorisation and approval from the UK Regulator – ceased to apply.

This means that a UK-based scheme may not be able to receive contributions from an EEA employer in respect of a Qualifying Person unless this is allowed by the rules of that EEA state. The UK scheme will need to comply with any conditions that the EEA state may apply. UK schemes that operated cross-border before 1 January 2021 will need specialist advice based on their specific circumstances.

2.3.4 Insured and Self-administered Pensions

Insured Pensions

An insured pension scheme is a scheme where benefits are provided by an insurance company under an insurance policy to which premiums are paid. Whether or not some form of insured arrangement is suitable for certain funds is discussed further in the Defined Benefit Arrangements Unit. If the avoidance of risk (both as to mortality and investment) is the overriding concern, provided that the insurance company is selected with care, these risks can be reduced by taking out a suitable insurance policy.

In the case of a scheme with a large number of members, the insurance contract may be no more than an investment vehicle chosen by the trustees for all or part of the assets of the trust fund. By contrast, in the case of a scheme with few members, individual insurance contracts may be taken out for each member of the scheme. In either case the insurance policy is issued by the insurance company to the trustees as the policyholder and the benefits provided by the policy are accordingly payable to them and not to the member.

An insured arrangement benefits from the security of an insurance company, which is regulated under the Financial Services and Markets Act 2000, standing behind it. There is also the protection available under the Financial Services Compensation Scheme if the insurance company goes into insolvency. However, the additional security comes at a price, because of the premium that will be payable in respect of the policy and the fact that the return on assets tends to be less than could be obtained from other investment vehicles.

Examples of insured pension schemes include both DB and DC retirement benefit schemes, stakeholder pensions and group personal pension plans.

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

Personal Pensions are examples of bundled products (arguably excluding SIPPs, see Chapter 1).

Where an insured scheme is unbundled, the different components are charged for separately or even provided by different organisations.

Self-administered Pensions

The term does not relate to the manner to which the scheme is administered. It relates to the way in which scheme assets are invested and generally means that instead of arranging the investment, administration and other services with one provider, usually an insurance company, the trustees seek separate organisations to provide fund management and administration services.

Self-administered pension schemes, therefore, tend to be those occupational pension schemes that are of a size to warrant more control by the trustees over the ways and methods by which assets are invested.

The scheme trustees are able to monitor investment performance on an ongoing basis and make changes to the managers of their investments in the light of poor performance.

2.3.5 Small Self-administered Schemes and other Executive Arrangements

A small self-administered scheme (SSAS) is a trust-based occupational scheme set up for a small number of employees, typically the owner-directors of a company, and selected key staff.

Because the members are able to direct investments, HMRC is concerned that the tax reliefs available to the pension scheme might be abused. In particular, members could acquire assets through a SSAS and then use those assets personally (for example a house or holiday home, or a work of art). Because of this, SSASs and other schemes where members can direct investments such as SIPPs (see Chapter 1.2.3) are classified as 'investment regulated pension schemes' and subject to special tax rules.

Prior to 6 April 2006, it was a requirement that all SSASs had an appropriately experienced professional trustee selected from an approved list of pensioneer trustees. Although this is no longer a requirement, the scheme documentation might still refer to a pensioneer trustee.

As well as SSASs and SIPPS, the other arrangements commonly used for senior company personnel are executive schemes and top up schemes.

Executive schemes (historically sometimes known as top hat schemes) are schemes that typically offer a higher level of benefits than is provided for the majority of the company's employees; alternatively, it might provide benefits of a different type – for example the executives might receive final salary benefits and the staff average salary or money purchase benefits. Having completely separate schemes is sometimes preferred to the alternative of providing benefits for the staff and executive in different arrangements but within the same scheme.

A top up, or supplementary, scheme is one that sits alongside the main scheme. The executive will be entitled to benefits from the main scheme at the same level as staff members, but these will be topped up to some higher amount by the supplementary scheme. When the executive retires, the benefits will often be aggregated and paid from one scheme only (a transfer payment being made between the two schemes).

Executives may also have retained benefits in legacy arrangements relating to previous periods of their careers during which they were self-employed (including as partners in a partnership). Often such benefits will be provided by personal pensions or their predecessors, retirement annuity policies (sometimes known as section 226 policies).

Where the executive's desired retirement benefits exceed the thresholds for what can be provided through a registered scheme, to benefit from the tax advantages of a registered scheme, the company may provide additional benefits from an employer-financed retirement benefits scheme (EFRBS, previously known as unapproved schemes). EFRBS are covered in 2.3.6 below.

2.3.6 Employer Financed Retirement Benefit Schemes (Formerly Unapproved Schemes)

Employer Financed Retirement Benefit Schemes (EFRBS)

Before the current pensions regime was introduced on 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). With effect from 6 April 2006, the concept of scheme approval fell away, and both FURBS and UURBS became known as employer-financed retirement benefit schemes – EFRBS (which is the term used here).

The tax and NI advantages of EFRBS have been steadily eroded by successive legislative changes, most notably Finance Act 2006 and Finance Act 2011. 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 off-shore, it was not subject to UK tax except on UK-source income (although a legislative change in 1993 effectively removed the tax exemption on benefits for any new offshore funded EFRBS).

Furthermore, the need for EFRBS reduced with the introduction of the April 2006 tax regime. The reason was that this regime removed the strict limit that applied previously on the benefits that could be paid out from an approved pension scheme. Up to 5 April 2024, benefits above the member's lifetime allowance could be paid , but subject to a lifetime allowance charge. The effect of this was to make the tax treatment of provision of benefits in a registered scheme in excess of the lifetime allowance broadly comparable to the tax treatment of EFRBS. However, the lifetime allowance charge on benefits that exceeded the LTA (£1,073,100) was removed from 6 April 2023, and the lifetime allowance itself was abolished completely from 6 April 2024.

Unfunded EFRBS

In an 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, but only at the point that the benefits are paid and the member suffers an income tax charge.

From April 2004 where provision through EFRBS continued, this tended to be done through unfunded arrangements because of the negative effect of the tax changes on funded arrangements (see below). The attractiveness of such arrangements from the employee's point of view could often be significantly increased by the introduction of some form of security. This would typically be triggered in the event of the employer's insolvency (or possibly change of ownership) and would result in an asset of the employer, or proceeds of an insurance policy, falling into a trust set up for the employee.

However, the Finance Act 2011 introduced a clampdown on disguised remuneration aimed at preventing the channelling of remuneration through third parties in order to avoid or defer income tax. While these changes usually did not affect unfunded EFRBS, they have an effect where the EFRBS is both secured and involves a third party such as an insurance company or trust. Where the disguised remuneration provisions apply, the member suffers an immediate income tax and national insurance charge on the employer contributions paid. The tax due when the benefits are eventually paid is reduced by the tax already paid, and the employer can claim immediate corporation tax relief.

The effect is to make new secured EFRBS much less popular, although arrangements that existed on 5 April 2011 and which are broadly unchanged since that time, may continue as they are protected from the 2011 changes.

Funded EFRBS

As mentioned above, unfunded unapproved schemes were traditionally provided for some highly paid employees but, because of the relative lack of security, some preferred to use the funded alternative.

However 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. These changes therefore amounted to a deferral of tax. In itself, this might have been attractive; but at the same time legislation that applied to other forms of employer benefit trust and which deferred corporation relief until the time benefits were paid out was extended to EFRBS. The term of such a deferral could be many years. Furthermore, when the relief was eventually given, it was calculated with reference to the amount of the contributions paid in rather than to the value of the benefits paid out. 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).

The introduction of a 50% top rate of income tax, together with a reducing corporation tax rate, might have made the tax deferral characteristic of EFRBS more appealing if it were not for the disguised remuneration provisions introduced at around the same time (see above). Where the disguised remuneration charge applies, the overall effect is to make the taxation of EFRBS no more attractive than the more flexible cash alternative.

For the reasons outlined above, it is uncommon for contributions to continue to be made to funded EFRBS. However, although some have been wound up, others continue to exist in a paid up form, since the funds that have arisen from contributions made before 6 April 2006 still enjoy certain income and inheritance tax advantages when they come to be paid out.

2.3.7 Investment-Regulated Pension Schemes and SIPPs

Investment-regulated pension schemes

An investment-regulated pension scheme is a scheme:

- where at least one of the members (or someone connected to him) is able to influence how his own pension pot is invested; or
- which is an occupational pension scheme with fewer than 50 members and at least one of the members (or someone connected to him) is able to influence what the pension scheme invests in.

An unauthorised payment will occur if the scheme invests either directly or indirectly in taxable property; this includes residential property. The restrictions are designed to prevent pension schemes being used as a tax- efficient vehicle for investment instead of for retirement saving.

Before the current tax regime was introduced on 6 April 2006 (A-day) a small self-administered scheme (SSAS) was a type of occupational pension scheme which met certain requirements, including not investing in insurance policies and having (usually) a maximum of twelve members, with at least one member being connected with another member, with the employer or with a trustee of the scheme.

Because the same individuals were invariably the members, the trustees, and the directors and shareholders of the employing company, special tax provisions applied to SSASs prior to A-Day. However, since 6 April 2006 SSASs have been subject to essentially the same tax and investment regime as all other registered pension schemes.

Self-invested Personal Pensions (SIPPs)

This is a personal pension plan that allows a member to select the scheme's investments. SIPPs are particularly attractive to those who want more control over their investments. They give the opportunity to invest in a wide range of investments in addition to insurance products, including some property (but as investment-regulated pension schemes they are subject to the taxable property rules outlined above. Contributions to a SIPP count towards an individual's annual allowance (and lifetime allowance up to 5 April 2024 – see 1.1 above).

Summary

The most common benefit structures found in occupational pension schemes are DB (including final salary and CARE schemes) and DC or money purchase. In the former, the amount of pension

which the member receives is directly related to pay. In the latter, the amount of pension reflects the contributions made to the scheme in respect of him and the investment return on those contributions. The most important difference between the two types of schemes is how they are funded and what this means for the burden of risk between the employer and the member.

Also provided are cash balance and hybrid schemes. CDC schemes were introduced in 2022. All of these can be insured or self-administered. Some schemes in the public sector are unfunded, and operate on the pay-as- you- go basis. There are many different design features to be considered when establishing a pension scheme. Companies often use separate arrangements to provide some of all of the retirement benefits for their top executives.

A personal pension scheme is a pension scheme that is not an occupational pension scheme and which is established by a person with permission under the Financial Services and Markets Act 2000 to establish such a scheme. In practice, this means that personal pension schemes tend to be provided by insurance companies. Personal pension schemes provide benefits on a DC basis.

Stakeholder pensions (generally a form of personal pension arrangements that met certain minimum requirements) were abolished for new members from 1 October 2012.

Employers have historically used funded and unfunded EFRBS (formerly known as funded and unfunded unapproved retirement benefit schemes) to provide pension benefits in excess of previous Revenue limits to senior employees. However, since A-Day these types of arrangement are becoming less popular.

Public sector schemes are normally set up by statute and they cover the employees of central Government, local authorities and various public bodies, including employees of the health service, teachers and the police.

In an insured scheme, the sole investment medium is an insurance policy.

From October 2012, employers are required to automatically enrol eligible workers into a qualifying pension scheme.

Self Test Questions

- What is meant by the term DB scheme?
- What is met by the term DC scheme?
- Outline the main reasons why employers have historically established funded and unfunded EFRBS.
- Outline the steps employers should consider taking in preparation for their automatic enrolment staging date.
- What is the difference between a final salary scheme and a CARE?
- How might a scheme contain both DB and DC elements.
- Explain the principal risks present in DB and DC pension schemes and explain how these affect the employer and the members.
- How do insured and self-administered schemes differ?
- Outline the main features of a public sector scheme.
- When designing a private sector scheme, what are the main design features that need to be considered?
- What are the differ

CHAPTER 3

Selecting a Trust, Master Trust or Contract-Based Arrangement

INTRODUCTION

As the previous chapter demonstrates, there are a number of different options available for providing workplace pensions. A range of factors will influence the employer's choice of pension scheme, including their budget and their aims in offering the scheme to its employees.

After reading this chapter, the student should be able to identify the advantages and disadvantages of the different options for providing workplace pensions. It is important that anyone involved with workplace pension schemes understands why an employer might choose one option for providing workplace pensions over another.

3.1 COSTS

With the exception of the largest schemes, trust-based schemes often involve a higher level of cost for the employer due to the need for the employer to fund not only the costs of establishing the scheme, but also the scheme's ongoing running costs such as administration and professional adviser costs.

Contract-based schemes in contrast are often cheaper for smaller employers. The establishment costs are low as they can be bought off the shelf and, as the provider handles all the administration, spreading the cost over all the employers participating in the arrangement, the ongoing running costs for any particular employers is contained. However additional costs may be incurred in relation to any voluntary governance arrangements that the employer may wish to put in place and any pensions-related employee communications that the employer chooses to make.

Master trusts are able to offer lower costs for employers than most trust-based schemes as they likewise benefit from economies of scale and are able to spread fixed costs over a large client base.

3.1.1 Employer Contributions

In a DB scheme the employer's contribution rate is variable and is determined by an actuary on a periodic basis (see Chapter 2.1.1).

Unless the scheme is being used for automatic enrolment (see Part 3, Chapter 3), an employer is not required to contribute to a DC pension scheme. Many employers do however contribute to the workplace scheme that they have made available to their employees. Employer contributions are usually expressed as a percentage of the employee's salary. Some employers will offer a fixed contribution level, regardless of the extent to which the employee contributes to the scheme, while others will match the employee's chosen contribution rate up to a ceiling. Contribution structures that increase the employer contribution level according to the employee's seniority or length of service are also popular, but care must be taken to comply with age discrimination legislation.

Employer contributions therefore are dependent on the benefit basis and not determined by whether a trust, master trust or contract-based scheme.

3.1.2 Short service refunds

Historically, trust-based schemes have been able to offer short service refunds to members who leave the scheme with less than two years' service. A short service refund does not include employer contributions which are retained in the scheme and, although not capable of refund to the employer, can be used to pay scheme expenses. Contract-based schemes are not permitted to offer short service refunds, although there is a short cooling off period in which an individual joining a contact-based arrangement can change his mind and receive a refund of any contributions made. However, short service refunds from trust- based schemes for members with more than 30 days' service has been abolished for new entrants from 1 October 2015, thus bringing trust and contract- based schemes broadly into line.

3.2 EMPLOYER CONTROL AND FLEXIBILITY

With some exemptions, such as master trusts and other trust-based schemes set up non-associated employers operating in specific industries, trust-based schemes offer an employer a far greater degree of control over scheme design and administration than contract-based schemes.

An employer can design an entirely bespoke trust-based scheme at the point of establishment and, as employer consent will usually be required for scheme amendments, can exercise a degree of control over the subsequent development of the scheme. The employer is also usually able to appoint some of the scheme's trustees. With a contract-based scheme, however, the employer's control is limited to the contribution level and the range of investment options. Beyond that, the employer is required to effectively take the scheme as it is.

Changes can be made to the operational aspects of a trust-based scheme if these are considered necessary in future – for example, if a service provider does not provide the requisite level of services or investment or retirement options prove not to meet member needs. If the employer does not like changes that the provider makes to a contract-based scheme, for example. In terms of the investment funds or the retirement options on offer, or feels that the scheme is being poorly administered, its only option is to move to a new scheme with an alternative provider. This is unlikely to be an attractive option for a number of reasons, not least the employee communications exercise that would be involved, and the fact that employees would be left with two pots relating to the same employment in different pension schemes.

Trust-based schemes can be designed to include automatic provision for dependants in the event of the member's death. Contract-based schemes usually require members to exercise an option to provide for dependants.

3.3 ADMINISTRATIVE BURDEN

Trust-based schemes carry a higher administrative burden than contract-based schemes. The scheme will need to be designed and established and then administered on an ongoing basis in a way which complies with the significant regulatory burden to which trustees are subject. This will require adviser and other service provider support and, although trustees can delegate many of their responsibilities, they must still ensure that they select appropriate advisers/service providers and monitor their performance. Most, if not all, of the trustees will be lay trustees who will not have the time or experience to be involved in scheme business on a day to day basis, and the employer will therefore need to provide administrative support to the trustees.

Contract-based schemes are largely off-the-shelf products involving limited set-up work, and the administration is carried out entirely by the scheme provider who will require little, if any, involvement from the employer beyond the deduction and payment of contributions and the provision of employee information.

3.4 RISK

Trust-based schemes are perceived as being higher risk due to the higher administrative burden and the legal requirements to which trustees are subject, in particular in relation to the management of

investments. As trust- based schemes are effectively employer branded, any member dissatisfaction with the scheme could also have a negative impact of the employer's relationship with its employees and on its reputation more generally. Failure on the part of the trustees to properly administer the scheme can, in some circumstances, lead to personal liability for the trustees.

Contract-based schemes carry a very limited administrative burden for the employer. Administration failures and poor investment performance are more likely to be associated by employees with the provider than with the employer (although this may not be the case if the employer has taken a more active role in overseeing the scheme and employees therefore perceive it as being actively engaged with the scheme). It will generally be the provider who is liable for any administration failures.

3.5 RETIREMENT OPTIONS

A trust-based scheme is unlikely to offer the full range of retirement options to members as, unless it is a very large scheme, it is unlikely to be cost effective for the scheme to do so. To access an option not provided by the scheme, members will need to transfer to another scheme providing that option. A contract-based scheme however is far more likely to offer the full range of retirement options given the greater economies of scale that such schemes enjoy.

3.6 EMPLOYER PENSION PROVISION EXPERIENCE

The employer is more involved in a trust-based scheme, so an employer who has no previous experience of making pension provision for its employees may prefer a contract-based scheme.

In contrast, an employer which has previously operated a trust-based DB pension scheme may prefer to continue with a structure that is familiar to it and its employees. Moving from one trust-based scheme to another also offers familiarity and therefore reassurance for employees who are moving from the old scheme to the new scheme.

3.7 EMPLOYEE PERCEPTIONS

A trust-based scheme is often perceived by employees, particularly those who have previous experience of trust- based scheme membership, as being part of the employer's operations and therefore under closer employer supervision than a contract-based scheme. The fiduciary nature of the duties owed by pension trustees also provides reassurance to employees that the scheme is well-managed.

In contrast, the fact that contract-based schemes are operated by insurance companies for the purposes of a profit-making business can lead some employees to feel that their best interests are not central to the scheme.

3.8 TAX RELIEF FOR LOW EARNERS

As explained at 1.2.2 above, contract-based schemes such as GPPs operate on a relief at source (RAS) method of tax of tax relief, whereas almost all trust-based schemes (with the notable exception of NEST) operate a net pay arrangement (NPA). While the two methods usually give the same ultimate result, there is a difference for some low earners (principally part time workers) whose earnings are below the tax-free allowance and who consequently do not pay tax.

Such employees do not benefit from tax relief on their contributions to a NPA (there is no advantage of pension contributions being deducted from pre-tax pay if no tax is being paid). However where RAS is being used, the provider can reclaim basic rate tax on contributions of up to £2,880 (assuming a 20% basic rate tax rate) even where no tax has been paid. This means that non-tax payers benefit as if they were receiving tax relief on contributions up to £3,600.

In the past, this has been more of a theoretical anomaly as very few pension scheme members would be earning less than the tax-free threshold. However in recent years, the threshold has increased so that it is now significantly higher than the automatic enrolment earnings trigger (see Part 3). For some employers therefore, this might be a factor worth taking into account when deciding what scheme to use for automatic enrolment.

In July 2020, HM Treasury published a call for evidence on the operation of the different methods used by pension schemes to administer income tax relief, and the improvements that could be made. In the Autumn 2021 Budget the Government announced that low earners will be due top-up payments in respect of pension contributions they have made using an NPA. The Government subsequently said that the first top-ups, for 2024/25 contributions, will not be paid until 2026/27, rather than in 2025/26 as originally suggested. The delay was due to other ongoing HMRC programmes and the complex IT changes required. Provisions to introduce these payments are included in the Finance (No. 2) Act 2023.

Digitisation of RAS was originally planned to be in operation from April 2025; however, after consultation with industry, the government has delayed implementation until at least April 2027.

3.9 COMPARISON

The table below evaluates what an employer might consider when selecting a trust, master trust or contract based arrangement and the advantages and disadvantages of each.

	TRUST	MASTER TRUST	CONTRACT
Contractual relationship (ignoring contracts of employment)	None – Trust law applies with the Employer(s) and Trustee being parties to the Trust and members		Provider and Employee. There is no contractual relationship between the Employer and Provider
Formal Scheme Documentation	Legal Advisers required to prepare trust documentation	Documentation prepared by Master Trust provider	Policies prepared by Provider
Trustees	Required	Appointed by Master Trust provider	Not required however Independent Governance Committee required
Regulated by	The Pensions Regulator		The Pensions Regulator and the Financial Conduct Authority
Administration	An Administrator will need to be appointed	Administrator appointed by Master Trust provider	Provider is the administrator
Scheme expenses	Met by employer	Met by employers but economies of scale	Normally met by charges deducted from member's fund(s)
Leavers	Vested leavers maintained in scheme		After leaving, the relationship is solely between the Provider and the individual
Benefit structures	DB or DC	DC only	DC only
Employer contributions	Variable for DB (employer usually meets balance of cost). Usually fixed for DC	Usually fixed	Fixed
Tax on Employee contributions	Net pay	Usually net pay	Relief at source

Summary

The type of workplace pension scheme (i.e. whether it is trust-based or contract based) will affect the governance arrangements that will be required for that scheme – both in terms of what the specific governance requirements are and in terms of who is responsible for ensuring that those requirements are complied with.

There are a range of advantages and disadvantages to both trust-based and contract based workplace schemes. An employer's decision as to which type of scheme to offer its employees will depend on which factors are most important to it.

Relevant factors will include the relative costs of the scheme, the degree of employer control, the level of flexibility offered by the scheme, the administrative burden associated with the scheme, the level of risk created by the scheme, the retirement options offered by the scheme, the employer's previous experience (if any) of pension provision, and likely employee perceptions of the scheme.

Self Test Questions

- Identify the factors that are likely to influence an employer in deciding whether to choose a trust- based or contract-based workplace pension scheme.
- Compare the employer costs involved in operating a trust-based workplace pension scheme with those involved in operating a contract-based workplace pension scheme.
- How does the level of employer control and flexibility vary between a trust-based and a contract- based workplace pension scheme?
- how does the administrative burden differ between a trust-based workplace pension scheme and a contract-based workplace pension scheme?
- Compare the main risks associated with trust-based workplace pension schemes with those associated with contract-based workplace pension schemes.
- Discuss why employees might prefer their employer to offer a trust-based workplace pension scheme rather than a contract-based workplace pension scheme.

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