PMI

Core Unit 3 – Running a Workplace Pension Scheme

STUDY MANUAL

PMI ACADEMY

About the PMI

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.

The mission of the PMI is ***"to deliver exceptional thought leadership, comprehensive education, advanced training, and recognised qualifications in pension management. With this, we are committed to fostering industry collaboration and driving innovation to enhance retirement outcomes".***

To achieve this, the PMI is:

- **Always forward-thinking**
  Our commitment is to support our members and partners in creating better retirement outcomes by leading the way in industry innovation and development. By fostering continuous learning, professional growth, and leadership, we empower our members to drive meaningful improvements and ensure sustainable, high-quality pension outcomes for the future.
- **Preparing the next generation**
  We will continue to ensure that future professionals and leaders in our industry have both the technical and leadership skills necessary to deliver high-quality, transformational pension fund management that adapts to and supports the financial needs of members throughout their lifetimes.
- **Shaping the future of pension outcomes**
  We will continue to collaborate with our members, stakeholders, and Westminster to influence and enhance policies and practices, ensuring sustainable and better outcomes for scheme members
- **Responding quickly to a changing world**
  We continually strive to improve practices within workplace pensions to help build better financial wellness. By setting ambitious standards, building a trusted pensions environment, we support our members in delivering better retirement outcomes and improved financial wellness for today and tomorrow.
- **Focusing on member-centric solutions**
  Scheme members are at the heart of our mission. We will continue to support the industry in developing solutions that adapt to the realities of living longer, retiring later, and our multicultural society – actively promoting a lifetime savings model that meets these evolving needs.
- **Empowering informed decisions**
  We believe it's crucial for scheme members to make informed decisions and engage in planning their financial future. We will collaborate with and encourage our members, partners, and stakeholders to develop innovative and effective strategies that empower scheme members to make informed decisions about their choices up to and at retirement.
- **Promoting excellence and inclusivity**
  We will promote best practices and standards within the pensions industry, prioritising ESG and fostering diverse thinking and inclusive practices.
- **Being committed to your success**
  We are dedicated to our members' success. Through education, guidance, and creating opportunities, we will continue to support career progression and the success of our industry partners. We will champion your personal growth, staying relevant to your present needs and preparing you for the future.

- **Promoting education and qualifications**
  We will build on our reputation as the leader in pensions education and qualifications – championing our PMI Pathway professional career routes, ensuring they remain relevant for our students, pension schemes and employers for the future.
- **Leading source of knowledge and information**
  We will gather the best and most relevant knowledge and information to keep our members updated and informed, supporting continuous professional and personal growth.
- **Actively facilitating partnership and community**
  We are committed to building inclusive communities that unite a diverse spectrum of professionals from across the industry. Our goal is to support and share best practices, encourage robust debate, foster collaboration, and deliver innovative change.
- **Champion professional standards**
  We will continue to lead, champion, and promote the importance of professional standards, positioning our members and accredited trustees as trusted and respected.

A word about PMI Qualifications

The PMI is the UK's leading professional body for those working in the field of employee benefits and retirement savings. It supports and develops the experts who are responsible for running the UK's pensions industry and is acknowledged as the body for establishing, maintaining and improving professional standards in every area of pension scheme management, consultancy and trusteeship.

PMI qualifications are recognised for both their depth and their standing within the industry. If you choose a single unit, standalone qualification, or a multi-unit qualification over a number of years, it is recognised by the Pensions Industry as having the depth and rigour to demonstrate the knowledge and expertise of those taking them.

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Study Support Partner

First Actuarial LLP provide pensions services to a wide range of employers and trustees across the different sectors and areas of the UK. We help clients by providing:

- **Pension scheme administration** – holding up to date records, providing members with information, drawing up scheme accounts and importantly paying pensions to people in retirement
- **Actuarial advice to trustees** – helping trustees meet all their legal duties, supporting them in understanding the financial position of the scheme and negotiating scheme contributions with employers
- **Consultancy advice to employers** – giving employers all the information they need to provide the right pension benefits for their employees, providing figures for their year-end accounts and helping them work successfully with pension scheme trustees and employee representatives
- **Investment advice to trustees** – offering common sense advice that helps trustees understand how their investment decisions affect the long-term cost of schemes so they are able to make informed decisions about the right risk and return balance
- **Financial wellbeing** – explaining how pensions work to groups of employees or in one-to-one sessions so they are able to make the right decisions for them knowing what the outcomes might look like

First Actuarial LLP was formed in 2004 and operates from six offices in Basingstoke, Leeds, Manchester, Peterborough, Tonbridge and London. We are an independent business wholly owned by our Partners and staff. We value our independence highly as it means we can be wholly focussed on the needs of our clients and can contribute freely and openly to policy debate.

We now employ over 450 people – scheme administrators and accountants, payroll specialists, IT experts, consultants, investment consultants, actuaries, group protection specialists, trainee actuaries and our support staff providing HR and office services. First Actuarial are passionate believers in training and offer support and assistance to all staff wanting to undertake study and gain qualifications. We don't believe in de-skilling or dumbed down processes – but we do value efficiencies and driving up quality. We believe you get these positive effects by training staff and giving them real autonomy, responsibility and development opportunities.

We also encourage staff to give back to the industry. Our employees act as examiners for the PMI and IFoA, serve on industry working parties and present at seminars. We are also Study Support Partners for the PMI.

If you want to know more about First Actuarial, please visit our website at www.firstactuarial.co.uk

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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:
PMI certification via Pathways caters to professionals at different stages of their careers, allowing them to specialise in specific areas of project management. This approach enables individuals to build a strong foundation in project management principles and gradually acquire advanced skills and expertise in specialised areas, such as agile practices, risk management, or program management.

Industry Alignment:
PMI's certification Pathways are designed to align with industry standards and best practices. By offering certifications that are recognised and respected globally, PMI helps professionals demonstrate their proficiency in project management, thereby enhancing their credibility and marketability in the competitive job market.

Career Progression:
PMI's certification Pathways provide a clear roadmap for career progression within the field of project management. By obtaining relevant certifications at different stages of their careers, professionals can demonstrate their commitment to continuous learning and development, thereby enhancing their prospects for career advancement and increased job responsibilities.

Standardisation of Knowledge:
PMI certifications are based on a standardised body of knowledge that is regularly updated to reflect the latest industry trends, methodologies, and best practices. By adhering to these standardised guidelines, PMI ensures that certified professionals possess the necessary skills and knowledge to effectively manage projects of varying complexities and sizes.

Global Recognition and Credibility:
PMI certifications are globally recognised and respected by employers, clients, and industry professionals. This global recognition enhances the credibility of certified professionals and increases their chances of securing employment opportunities, working on international projects, and accessing a broader network of project management professionals worldwide.

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

Running a workplace pension scheme has become increasingly complicated and time consuming in recent years.

Much of the extra work is needed to comply with the UK's ever increasing pension legislation. This has various aims, for example:

- to make pensions available to (nearly) everyone (automatic enrolment)
- to protect member benefits (preservation, the Pension Protection Fund (PPF), priority order on winding up and the debt on the employer)
- to limit tax reliefs available (lifetime and annual allowances)
- to ensure good governance (disclosure regulations, the Pensions Regulator's data requirements)

Developing technology has helped administrators meet these requirements, but has also led to increasingly sophisticated systems being needed to meet member expectation (for instance for members to be able to switch investment choices online).

It is vital that those responsible for running workplace pension schemes understand the legal and regulatory requirements and how these can be met in practice. This study manual sets out the legal requirements and what these mean in practice in the day to day administration of a workplace pension scheme, in particular:

Part 1 sets out the system requirements for administering workplace pension schemes. It also includes an overview of data protection and how systems have evolved over time. Part 2 considers the automatic enrolment requirements for employers and employees. Part 2 also looks at the Pensions Regulator's regulatory guidance. Part 3 looks at the various benefit options that an occupational pension scheme may provide, and the different ways of communicating with members. Part 4 looks at the tax reliefs available on pension savings, the limits which have been imposed on these and the various changes that have taken place over time. Part 4 also looks at the different protection measures that have been introduced because of these changes. Part 5 looks at the various aspects of treasury management that occupational pension schemes need to consider. Finally, Part 6 looks at certain special issues occupational pension schemes may need to consider. These include winding-up a trust based occupational pension scheme, GMP reconciliation, combatting pension scams, and cyber security.

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Part 1

DESIGN

OVERVIEW

This Part comprises four chapters.

It considers the design and system requirements for the administration of workplace pension arrangements.

Chapter 1 examines administration system design and Chapter 2 explains the interface between workplace pension arrangements and payroll and human resources, and also looks at data protection. Chapter 3 outlines the use of the internet and of intranets. Finally, Chapter 4 covers online functionality and enrolment.

CHAPTER 1

ADMINISTRATION SYSTEM DESIGN

INTRODUCTION

The administration of pension schemes relies on computerised systems to hold member data, to calculate members' benefits and a variety of other functions. An understanding of the key requirements of any computerised administration system is an important part of understanding how pension schemes operate in today's world.

A well-designed system will optimise efficiencies by allowing streamlining of procedures and processes between the relevant employer, trustees and the administrators.

The employer payroll, whether in respect of an in-house arrangement or where administration is provided by a third party, plays a particularly important part in a defined contribution (DC) scheme. If the payroll system is inadequate and delays in receiving contributions into the arrangement occur, it will be the DC member who may suffer financially from the impact.

1.1 THE PENSIONS REGULATOR'S GUIDANCE

Schemes need to hold data that is common to all schemes as well as other types of data that is conditional on a number of factors. The Pensions Regulator (TPR) has issued guidance and provides more information about common data and scheme-specific data on their website. TPR suggests that data quality should be reviewed on an annual basis. TPR expects data scores to be submitted each year in the scheme return.

Schemes need to keep records for a minimum of six years after the member is no longer entitled to any benefit under the scheme. However, some records, including both common and scheme-specific data, will need to be kept for a much longer period.

The common data items for all schemes are:

- NI Number
- Surname
- Forename/initials
- Sex
- Date of birth
- Date started pensionable service/policy/contributions
- Expected retirement date/ target retirement date
- Membership status
- Last status event
- Address
- Postcode

1.2 SYSTEM REQUIREMENTS

Trustees and administrators using any computerised system must ensure that the system provides the appropriate level of:

1.2.1 Reliability

Any systems failure can have serious consequences for the scheme administration function. Administration providers (whether 'in house' or 'third party' providers) should have:

- Contingency plans in place covering the possibility of a systems failure
- Service agreements with systems providers covering systems recovery time
- Arrangements for the backing up of data
- 'Disaster recovery' plans to mitigate the risks of catastrophic events such as terrorism, fire or flood

1.2.2 Flexibility

All computerised systems must be flexible enough to accommodate changes in scheme design and legislation. Administrators should have agreements in place with their systems providers covering systems changes and developments.

1.2.3 Security

The storage and processing of personal data is governed by the Data Protection Act 2018. Trustees must register with the Information Commissioner as the 'data controller' and provide a statement explaining the arrangements they have to keep members' personal data secure.

Administrators are 'data processors' as they process data on behalf of the trustees. Trustees must satisfy themselves that any systems used by their administrators have adequate safeguards to keep member data secure and that the trustees and their administrators comply with the data protection principles.

Practical measures like the use of encryption codes should be used when transferring or sharing data electronically.

If members are given direct access to their data and benefits, the interface should be clear and fool-proof.

1.3 BASIC SYSTEM REQUIREMENTS DEFINED BENEFIT (DB) SCHEMES

As well as storing member data and calculating benefits, computerised systems are more often than not used for:

- The production of letters and emails
- The production of benefit statements
- Data extracts for actuarial valuations and scheme accounts
- Data extracts for HMRC returns and reports
- The operation of a payroll facility and production of P60s for pensioner members
- The monitoring of work within the administration function ('workflow')
- Electronic scanning and storage of documents
- Electronic transfer or submission of data between parties

1.3.1 Accuracy

Computerised systems must be capable of holding all the data needed to calculate members' benefit entitlements. Benefit calculation routines must be accurate so that all members receive their correct entitlement. There are usually some members with special circumstances (e.g. special historic benefit promises) that automated calculation routines will not support. Computerised benefit calculation systems must identify these members and produce some form of warning message so that administrators know that a special calculation is needed.

When data held on the system is updated (for example as part of the annual renewal), suitable checks should be made to ensure the accuracy of any new data that has been input.

Any amendments to automated calculation routines must be fully tested to ensure they continue to produce accurate results.

1.4 BASIC SYSTEM REQUIREMENTS DEFINED CONTRIBUTION (DC) SCHEMES

Technology and its use within the administration of DC schemes is an area that requires careful consideration. Historically, DC schemes have been considered to be much easier and cheaper to administer than DB schemes. When DC schemes were first introduced, scheme design tended to be relatively simple with often only one or two investment fund choices for members and only one investment fund manager. Over recent years however, DC schemes have become increasingly complex and as such the DC administration system now needs to be able to deal with the complexities of lifestyling and investment switching, together with a raft of legislative requirements relating to benefit payments. DC schemes are only easy to administer if the software system can cope with such requirements.

Traditionally, the pensions department was often the poor relation within the corporate structure. HR and payroll were seen as essential functions within the business, and as a result, have had far more investment in technology. It is only recently that schemes, members and the pension industry as a whole have been fully benefiting from technological advances in software and system design.

There are a number of basic requirements of a computer system to allow the successful administration of a DC scheme. The system must be capable of storing and maintaining a number of basic items of data.

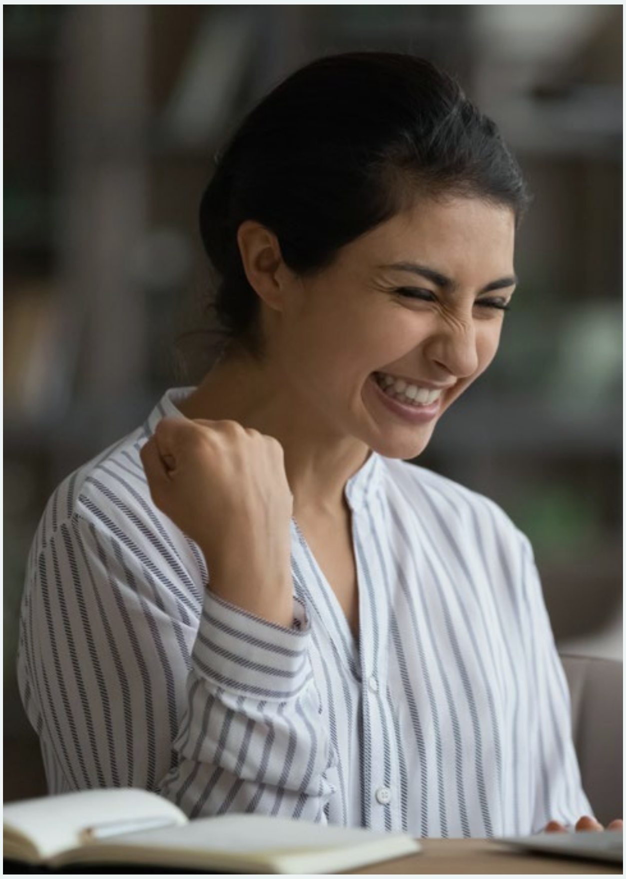
1.4.1 Member Details

In addition to the common data items mentioned in section 1.1, the following items should be the minimum data stored:

- Date joined company
- Pensionable pay
- Membership category
- Investment choices – lifestyling switch dates

The following additional items may also be stored:

- Marital status
- Target retirement date (where different from that of the scheme's Normal Retirement Date)
- Payroll number
- Employing company or location
- Branch/unit code
- Periods of absence, including maternity
- Personal health insurance (PHI) cover
- Transfer in details (if applicable)



1.4.2 Contributions And Units

For each type or 'stream' of contribution the administration system should hold a record of:

- The contribution rate – i.e. whether a percentage of salary or a fixed monetary amount
- The amount of contribution received
- The units purchased for each investment relative to that 'stream'

The contribution 'stream' relevant to a member will vary depending on the nature of the scheme and the member's specific circumstances, but can include:

- Employee regular contributions
- Employer regular contributions
- Additional Voluntary Contributions
- Any employer special contributions received (e.g. from salary sacrifice or bonus sacrifice)
- Transfers in received

Further to the items listed above, the administration system should also hold for each member the following:

- Date contributions are received
- Date contributions are invested
- Transaction history of units bought and sold such as where:
  - Contributions have been invested for the member
  - There has been a switch in investment funds following a change in the member's investment strategy or as a result of lifestyling
  - The member's unit allocation has been rebalanced so that the monetary value of the unit holding between each investment fund matches the member's investment strategy
  - There has been a disinvestment, either in part or in full, due to a transfer (e.g. pension sharing order) or the member crystallising benefits
- Unit prices for each fund for any date on which investment or disinvestment transactions take place

As well as fund holdings for each member, the system may also be required to hold separate investment holdings, which can result from processing short service refunds to members where the employer investment amount is not disinvested. These amounts are often held as a balancing item and may be referred to as an 'unallocated account'.

1.4.3 Switching And Lifestyling

Lifestyling is a means by which funds are gradually moved into less volatile investments as a member approaches retirement age. Lifestyling members are given some protection from market volatility drastically affecting the value of their funds at retirement. It is often designed by the trustees/managers using the scheme's normal retirement age. However, it is also possible for members to select a target retirement age and the system should be able to handle either option.

The system must be able to handle switches of individual member investments between different funds, either on member request or automatically, as part of the lifestyling process.

1.4.4 Charges

There are a variety of ways in which charges can be applied and collected from a scheme. For example:

- The unit price set by the investment manager can be adjusted to take account of their charges
- The charge can be deducted from new money invested so that, for example, 99% of the contributions would be invested, and 1% retained by the investment manager
- The charge can be deducted from the member's 'pot' either based on a fixed monetary amount, or as a percentage of fund which in turn can be capped at a fixed amount

In the past, the level of charges could vary according to the status of the member – active or deferred member (former employee). However, from 6 April 2016, active member discounts were banned.

It is common for a scheme to apply more than one type of charge at the same time and so an administration system will need to be flexible enough to allow for this as well as being able to vary the rate of charges being applied potentially at an individual level.

The application of charges on pension savings has been the subject of much debate with regards to the level they are applied at and the level of transparency for employers and members. Employers are being urged to consider closely the impact of charges especially when selecting a default fund for a qualifying scheme to meet their automatic enrolment duties. In order for a scheme to be considered a qualifying scheme, the charges that are applied must fall below a defined level (see Part 2).

1.4.5 Calculations

The main and most frequent calculation that the system will be required to perform will be to value a member's fund on any given date. This is a relatively straightforward calculation requiring the system to identify the latest fund price and multiply this by the unit holding.

DC schemes are required to provide Statutory Money Purchase Illustrations (SMPIs) to members on an annual basis. SMPIs provide members with an indication of the benefits they may receive at retirement from their DC scheme. This has created a need for the system to be able to calculate and produce these figures annually. The SMPI calculation is relatively complicated and requires various assumptions (for example, assumptions on frequency of pension payments, how the pension will increase) about the future to be incorporated into a system's calculation routines.

1.4.6 Reporting

One of the main functions of a good administration system is the ease of reporting. Usually reports would be needed for:

- Standard administration reports, e.g. member movements, members approaching retirement age
- Contributions paid by employees
- Contributions paid by employer
- Unit holdings per member
- Units purchased on any given date
- Units sold on any given date
- Total unit holdings per fund
- Lifestyling events

It is imperative that a full audit trail of any system changes or transactions can be produced, to provide clarity to the administrator and members, to provide comfort to the trustees/managers/employer and to provide information to the auditors.

Summary

This Chapter has provided a summary of system design for pension administration for both DB and DC arrangements.

Self Test Questions

- List the 11 common data items
- Describe the ways in which charges can be applied and collected from a DC scheme
- Outline the basic system requirements for DB and DC schemes

CHAPTER 2

INTERFACES WITH PAYROLL AND HUMAN RESOURCES (HR) AND DATA PROTECTION

INTRODUCTION

There are a number of different ways in which contributions can be received by the scheme administrator from the various payroll sites. The scheme administrator must agree with the payroll department the means by which the data is transferred from the payroll system to the administration system. Paper schedules and spreadsheets are two of the formats in which contributions can be received and these have both been widely used in the past.

2.1 INTERFACES

As a result of advances in technology, building interfaces to transfer data from one system to another is on the increase. The use of interfaces to transfer contributions from the payroll system to the administration system has the following advantages:

- The process is automated but allows for a degree of validation
- Automated reports identifying any errors speeds up the identification of unreconciled members/contributions
- Minimal human intervention in the process reduces the chance of human error

HR interfaces may also be used to transfer member data in addition to contributions, e.g. updates to pay, address details, etc.

When setting up interfaces between systems, the scheme and the payroll department need to decide who is driving the data through and which system is the data owner. In most situations, it is usually the payroll department who is the driver; they push the data through to the administration system. An alternative would be to have the scheme as the data owner, with the scheme providing a pre-populated contribution schedule for the payroll department to check and agree.

2.2 MIDDLEWARE

Middleware is computer software that sits between different software applications to provide additional functionality from that already provided. This type of solution is often provided by a third party where the replacement or development of the current systems would be too costly or time restrictive to meet the specified requirements.

This software solution has been adopted by many employers to facilitate their duties for automatic enrolment. Successful implementation of middleware is critical for these duties as there is specific information that has to be passed between an employer's payroll, HR and pensions functions to ensure that worker assessments and reporting requirements are met.

Advantages for an employer to adopt middleware as an automatic enrolment tool include:

- A single over-arching process will remove the requirement for the associated HR, payroll and pensions administration tasks to be carried out manually
- The employer and their workforce will see a single joined up, end to end process
- Management information should be available from one place
- In–house system development costs to meet the employer duties for automatic enrolment is currently out of reach for most small to medium employers
- Support will be available where changes are required as a result of legislative change or a change in the dynamics of an employer's workforce
- Depending on the nature of the workforce, automatic enrolment requirements can be complicated and the expertise to develop a system may put a strain on available human resources

2.3 DATA PROTECTION

Trustees/managers of schemes and administrators must comply with their obligations under Data Protection Legislation. The European Union General Data Protection Regulation (EU GDPR) came into effect on 25 May 2018 and was enacted in the UK through the Data Protection Act 2018 (DPA 18).

Following Brexit, EU GDPR was replaced with 'UK GDPR' which is almost identical legislation. This new legislation is simply a copy of GDPR but with references to the EU replaced by references to the UK.

DPA 18 makes provision for the regulation of the processing of personal data relating to individuals, which includes the obtaining, holding, use or disclosure of such personal data. It also applies to any personal data held or processed on a pension scheme administration system.

Personal data is defined as any information relating to an identified or identifiable natural person. The identification may be done directly (for example, name) or indirectly (for example, using a number that can be used to look up a name). An individual may be identified by a range of personal identifiers, for example, a member's IP address, name, address, national insurance number and email address.

DPA 18 also covers "special categories of personal data" which replaces what was known as sensitive personal data. This category includes items such as health and sexual orientation. This type of personal data is subject to additional protection.

DPA 18 contains six data protection principles, and they are:

- Lawfulness, fairness and transparency – there should be a lawful reason to collect the data and it should be clear to the individual what data is collected and why
- Purpose limitation – data should only be used for the purpose for which it is collected
- Data minimisation – only data that is necessary should be collected
- Accuracy – data should be accurate and where necessary kept up to date
- Storage limitation – data should be kept no longer than necessary. Most data collected by pension schemes is likely to be needed for very long periods.
- Integrity and confidentiality – data should be kept securely.

DPA 18 applies to "controllers" and "processors" and the definitions are broadly the same as under the Data Protection Act 1998. In summary, the:

- data controller determines the purposes and means of processing personal data. The controller is responsible for demonstrating compliance with the data protection principles
- data processors process the data on behalf of the data controllers

For pension schemes the trustees are the data controllers; whilst the scheme administrator is normally a data processor.

The trustees/managers, as data controllers have ultimate responsibility for the data. They will decide matters such as the reason to collect the data, what data is collected and how long to keep the data.

Pensions administrators will process the data on behalf of the trustees/managers. Pension administrators can justifiably be given access to virtually all information regarding a member, as it is deemed necessary for performing their duties.

However, as administrators are processers,the decisions on the matters such as who to share the data with are ultimately taken by the trustees/managers. Although, in practice, the trustees/managers may rely on the advice of the administrators.

Other parties such as an employer representative may also be interested in pension scheme data. The trustees/managers must also comply with the principles of DPA 18 when deciding what information to disclose to such third parties. It is likely that the trustees/managers will decide that an employer representative should only have limited access. This may include only current data, or data that has been anonymised.

Under DPA 18, individuals have a number of rights. This includes the right to have access to their data. This is known as a subject access request. The period to supply the information requested is one month and should be supplied at no cost.

Where requests from an individual are manifestly unfounded or excessive, in particular because of their repetitive character, the trustees/managers may either:

- charge a reasonable fee taking into account the administrative costs of providing the information or communication or taking the action requested; or
- refuse to act on the request

However, it is the responsibility of the trustees/managers to demonstrate the manifestly unfounded or excessive character of the requests.

DPA 18 also increased the fines for not complying with legislation. Both the data controller and the data processor may be fined in the event of a data a breach. The maximum penalty is the higher of £17.5 million or 4% of worldwide annual turnover.

The Information Commissioner's Office (ICO) provides resources on its website to assist trustees/managers and administrators with understanding their duties under the Data Protection laws (see https://ico.org.uk/for-organisations/guide-to-the-general-data-protection-regulation-gdpr/)

ICO also provide a 12 step checklist and a Data Protection self-assessment tool to assist. More detail can be found at

https://ico.org.uk/for-organisations/data-protection-self-assessment/

The government has announced there will be a "Digital Information and Smart Data Bill" that will include the restructuring of ICO.

2.4 CYBER SECURITY

Pension schemes hold large amounts of personal data and assets which can make them a target for fraudsters and criminals. Trustees and scheme managers need to take steps to protect their members and assets accordingly, which includes protecting them against the 'cyber risk'. This is an issue which all trustees and scheme managers, regardless of the size or structure of their scheme should be alert to.

Cyber risk can be broadly defined as the risk of loss, disruption or damage to a scheme or its members as a result of the failure of its information technology systems and processes. It includes risks to information (data security) as well as assets, and both internal risks (eg from staff) and external risks (eg hacking – see Part 6, 3.3.8).

Summary

This Chapter has provided an overview of the interface between pension administration systems and payroll and HR. It included a brief description of middleware, data protection and cyber risk issues.

Self Test Questions

- What are the advantages for adopting middleware software for automatic enrolment
- Briefly explain the use of interfaces
- Explain when GDPR came into effect, who are data controllers and data processors and the potential fines for non-compliance

CHAPTER 3

INTRANET VERSUS THE INTERNET

INTRODUCTION

The adoption of the web as a tool for the pensions industry has occurred in stages and different areas of the industry use the facility in a number of different ways.

The internet is a worldwide, publicly accessible network of interconnected computer networks. Most websites on the internet can be visited by anyone with access to a computer. When employers or schemes are considering posting information on an internet site, they therefore need to be comfortable with everyone having access to the information on it.

The intranet is an internal version of the web. The information is held within the internal company network and in contrast is not accessible to outside users. Within the intranet, an internal information site can be set up to include company information. It would normally include HR details, such as the employer's handbook, company guidelines, standard forms; e.g. holiday or sickness forms, as well as more general company information such as product range, history and organisational structure. It is not generally accessible outside of the company network, unless employees are given very specific security to access via the internet.

The sponsoring employers of schemes often provide information via their intranet. This restricts access to the information to employees only. Access to online information is therefore not available for deferred members or pensioners who are no longer employed by the company.

The internet is therefore attractive to schemes who want all categories of members to have access to their scheme details. However, the question of security and data protection arises. Most sites will employ the use of a secure area. Members, trustees/managers, employers or their advisers may be provided with access to information held behind the security controls. Software has been developed to provide the person accessing the site with an account number or username and password, which must be entered before the individual can view the information held upon the website. This security also ensures that the person has access to only information that they are authorised to view.

Recent developments have seen a holistic approach with a single access method, linking the intranet site to the internet. This has the advantage that members can access employer and pension benefits through one portal.

3.1 USE OF THE WEB BY SCHEMES AND MEMBERS

There are many ways the web can be used by a pension scheme and its members including:

- Electronic communications at either an individual or group level
- Provision of educational support including access to scheme specific literature
- Flexibility to perform administration tasks without direct involvement of the scheme administrator (for example, changes of personal details).

3.2 STATIC INFORMATION

The earliest use of web functionality within the pensions industry was the provision of static information websites. Both in-house and outsourced arrangements began providing information regarding the scheme online. This information was, to an extent, a visual reproduction of the member booklet.

The advantages of providing static online information are that it:

- Can be amended within hours rather than weeks or months
- Can be amended for very little cost
- Does not involve the costs associated with reprint as with hard copies
- Is possible to direct members to the website for instant access to up to date information
- Is possible to email members and potential members the hyperlink to the pension website
- Saves money on stationery and postage

3.3. INTERACTIVE INFORMATION

The next stage of development introduced more interactive elements, which assisted in communicating the benefits to the member, whilst also educating them. This included features such as:

- Answers to frequently asked questions
- Bulletin boards for pensioner groups promoting social activities and pensioner welfare
- Hyperlinks to related pensions sites, such as:
  - MoneyHelper
  - TPR
  - Fund Managers
- Access to personal details for members, including:
  - A summary view of their personal details from their member record
  - A view of their completed nomination or expression of wish form
  - A view of their fund holdings including their contribution splits
  - A view of their last benefit statement and possibly previous benefit statements
  - A facility to email enquiries to the pensions administration team
- The introduction of financial modelling tools for members
- Access for trustees/managers/advisers/ employers to externally administered schemes
- Availability of high level scheme management information for employers/trustees/managers/ advisers

3.4 ABILITY TO UPDATE

Giving members the ability to not only view but also to update their records was a serious breakthrough in the administration of pension schemes. It meant that members could, for the first time, input information onto the system themselves. Members could update changes to their address or marital status, beneficiaries or dependent children. They were also able to change their contribution rates and investment choices.

3.5 MODELLING TOOLS

The first modelling tools were used for DC schemes and were standalone and not linked to the member's actual data. These required members to enter details regarding their salary, age, contribution rates and retirement age. The model could then work out the projected fund value and forecasts of options at retirement, such as:

- The annuity the member could expect to receive at retirement
- Flexi access drawdown options
- Cash lump sum available.

The next generation of modelling tools were produced by taking data from the member's record, pre- populating the screen with the member's contribution rates, investment choices and target retirement date and projected pension at that date. Members were able to model their benefits by changing their contribution rates to see the effect on their pension or input a target pension to see what contribution rate would be needed to reach it.

The latest generation of modelling tools uses the same calculation rules as the administration system used by the scheme administrators.

The use of modelling tools is becoming more and more important to schemes as they look to encourage members to seriously consider their retirement options. Some of the latest tools developed enable members to input additional information, such as mortgage commitments, and use these to give a real-life reflection of living costs during retirement.

3.6 REAL TIME ACCESS

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

The use of real time access opened up debates as to whether schemes wanted members to see their details. What caused concern was the state of the data and how much was out of date or incorrect. Some schemes felt that it was a risk to allow members to see the data held on their member records. Others saw it as an opportunity to clean the data. By allowing access via the web and encouraging members to review their details, these schemes found that the data became self-cleaning. Experience has shown that members are more likely to amend and update the scheme with details regarding their marital status, dependants and addresses via the web.

A further concern when web capabilities were being developed revolved around security. The two main concerns were:

- that computer hackers would use the pension website to send a virus into the network and crash or corrupt the pension records or the company's internal systems.
- that members would worry that other people could hack into the website and view their personal details.

To address the first point, the system providers initially solved the problem by setting up standalone copies of the working pension system. The data on the standalone copy system would be refreshed with the data held upon the production system either on a weekly or monthly basis. This was a long winded but secure method of allowing access safely.

The problem with this solution was that access and updates were one way. Members could see their details but could not update their personal records. This method usually offered the option of emailing the administration team directly from the website or completing a template that would make the member think they were updating their records.

The data transfer between the live system and the copy system, however, soon became a two way process. This meant that certain update actions would kick start a workflow item in the administration team. For example, a change of address would set off a task for the automated production of a confirmation letter.

Particularly for DC schemes, the timing of updates could have an impact on the periodic cycle of events and therefore it is important that updates, changes or requests by members are actioned as soon as possible.

Real time access is growing amongst pension schemes as trustees/managers and employers become more comfortable with members having access to their data. What the member now sees is the same data that administrators see, but usually in a much simpler format. The web pages are simply a different presentation of the underlying data. Administrators, however, generally have access to much more information about the member and the scheme.

Giving members real time access benefits schemes by:

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

3.7 DISCLOSURE REQUIREMENTS

With effect from 1 December 2010, pension schemes have been able to fulfil a number of their disclosure requirements using online media, as well as through traditional written communication. This can include emails, intranets and the internet.

Schemes can therefore provide traditional communications such as benefit statements by email and provide links to online documents rather than hard copies. However, members must be given the opportunity to opt out of the electronic communication and continue to receive hard copy documents.

Information can only be given by electronic means where the trustees/managers are satisfied that the recipient will be able to get access to and store or print the information, taking into account the requirements of people living with disabilities.

Clearly this presents the opportunity for cost savings for schemes, especially where a large proportion of the membership adopts electronic communications. In addition, this allows documents on a website to be signposted, ensuring up to date versions are always available.

3.8 ACCESS FOR TRUSTEES, EMPLOYERS AND ADVISERS

Where an external body administers a pension scheme, the internet has also become a valuable tool. Like scheme members, other parties can be given access to information via the internet.

3.8.1 Employer/Trustee Access

A pensions manager employed by the scheme sponsor or an internal pensions team may be provided with access to a third party administrators' (TPAs) system via the internet.

Areas where this may assist include:

- Scheme level information
  - Membership movement statistics
  - Fund values
  - Contribution levels
- Member level access
  - Update and view individual members' records
  - Ad hoc member enrolment
- Management information
  - Statistics for service level agreements
  - Monitoring workflow
  - Identifying where an item of work is within a process

  In addition to being a useful tool for keeping abreast of the day-to-day administration of the scheme, the internet can also be a tool for transferring data.

3.8.2 Payroll Access

Data can be transferred between the administration system and the payroll system using the internet. This process has become very sophisticated. The pensions administrator can send the payroll department a pre-populated file of expected contributions including any new entrants and any changes or deductions to the schedule. In turn, the payroll department can check and validate the file before approving it for loading onto the system. This is all conducted via the internet.

3.8.3 HR Access

The HR department can also make use of this facility. The HR department can upload new members or changes to members' details using this facility.

3.8.4 Scheme Advisers/Independent Financial Advisers

Members' financial advisers or the scheme adviser could be given limited access to information via the internet.

Self Test Questions

- Explain the issues schemes face when they use the internet
- Outline the advantages of static online information
- What are the advantages of giving members real time access
- Describe how schemes can satisfy disclosure requirements via the web

CHAPTER 4

ONLINE FUNCTIONALITY AND ENROLMENT

INTRODUCTION

This Chapter considers how online functionality can assist with enrolment. It also covers online switching and straight through processing.

4.1 MEMBER ENROLMENT

Since the introduction of automatic enrolment employers must enrol members into a qualifying pension scheme if they meet the eligibility conditions. Many employers have taken advantage of the technological advances to ensure they meet their statutory duties. Employers have to provide an information pack once a member has been automatically enrolled into a pension scheme, and this may include details of how to register on the scheme website. Members who don't meet the eligibility conditions to be automatically enrolled into the pension scheme can be directed to the website to join.

Under data protection laws, data controllers must provide data subjects with privacy notices at the time personal data is obtained. As a member's enrolment is the first point at which trustees will obtain a member's personal data, the member should be presented with the trustee's privacy notice during the enrolment process, or at the very least, be able to access a hyperlink to review the privacy notice.

Following completion of member enrolment, a welcome pack is either posted or emailed to the member. For stakeholder and GPPs, a policy document and cancellation notice are also provided.

4.2 MEMBER REGISTRATION

Directing members to register on a website to view pension scheme information has definite advantages. It allows members to read and digest information at their leisure as well as introducing members to the pension website and functionality. Research has also found that if members register online, they are more likely to make use of the facility going forward.

4.3 THE PROCESS FOR REGISTRATION

The member visits the pension website or intranet site after having consulted the scheme booklet, investment guide or other information available. Having made the decision to register on the website the member visits the registration page. The member enters the necessary information. If the member has difficulties, there may be the option to view an online help facility or select the most appropriate entry from a drop-down list. Having completed the registration form, the form is submitted by the member online and this kick starts action by the administrator.

The administrator picks up this piece of work from the work queue. The information that the member entered online is reviewed before accepting the member onto the website.

4.4 ONLINE SWITCHING

Online switching offers the ability for members to change their investment choices via the web functionality offered by their pension scheme. This enables members to switch their future contributions and/or rebalance their existing fund values.

4.4.1 Online Switching In Theory

Members can visit their pension website and have access to all their latest fund values, split between each fund, together with a record of the contributions they have made into each. They can look at the fund factsheets to see how each fund manager has performed and review the risk profile attached to each.

Members have all the necessary information at hand to make an informed choice.

This web facility allows members to redirect their future contribution and/or rebalance their funds. Information passes through the administration system, which sends off the appropriate disinvestment and investment instructions to the investment manager. In another part of the system, changes to the contribution rates are picked up and notified to the payroll department in the next payroll pre-populated schedule. This may not require any input from the administration department, or it may be passed to them for validation and checking.

4.4.2 Online Switching In Practice

Real time switching is becoming more common, but is not a standard approach for several reasons:

- Technology solutions can be costly
- Trustees/managers are wary of members making a decision and this being implemented without the administrators first having sight of the action, due to:
  - Worry that the dealing cycles may not be understood by the members, for example, the concept of time out of the market if the switch is between fund managers
  - Members may not understand that they have to request the switch by a certain cut off point or that day's cycle is missed
  - Members may not understand that the price they see on the screen will not be the price used for the deal
  - The trustees could be charged per transaction and unlimited switching could increase the costs of administration considerably.
- Technology is a major barrier:
  - Interfaces between pensions administration systems and investment dealing systems are rare, unless responsibility for the administration and investment management are with the same provider and they have developed integrated systems. Where they do exist, it often only works if the different funds are on the same platform.
  - Until recently, there was an unwillingness to take responsibility for building or paying for the integration between the different platforms. This, however, is starting to change with the advent of straight through processing.
  - Until recently, there was no industry standard means of communicating electronically between investment managers and different administration platforms. Indeed, some providers have not yet adopted straight through processing.
  - Members may not have access to the internet or may lack confidence in making decisions in this way

4.5 STRAIGHT THROUGH PROCESSING (STP)

STP is the ability for two computer systems to exchange and process information without human intervention. Members will see a single joined up end to end process. STP provides an industry standard means of communicating electronically between investment managers and different administration platforms. It therefore offers considerable benefits in terms of speed, cost savings and reduced risk of error and will undoubtedly become more popular in the future.

Prior to the introduction of STP, the interfaces between administrators and investment managers were built around manual processes for exchanging data. However, with the development of STP, there is reduced manual intervention in investment transactions, which should lead to a quicker exchange of information, providing greater efficiency and improving risk control.

4.6 THE BENEFITS OF STP FOR DC SCHEMES

Where a switch in investment funds is conducted using the manual process, the process begins with an instruction from the member, sometimes in hard copy. This needs to be processed and checked by the administrator before the relevant disinvestment instruction is created and sent to the fund manager. The transaction is twofold - buying and selling. The buying element cannot be performed under the manual process until the selling transaction is complete. The limitations of manual processing are the time delays involved, which could mean that the member's funds are out of the market, and the risk of human error.

With STP, the creation of an electronic interface between the administration systems and fund manager allows reconciliation of units trade-by-trade and eliminates the need for human intervention during the investment process. The data is transferred rapidly between all parties involved. An investment instruction is issued automatically, and the transaction confirmation is received much faster. With this method, there is less chance of human error and less out-of-market time for members.

Summary

A well-designed system will ease the burden of scheme administration. It is essential that schemes take advantage of technology as a means of communication and education in order to ease the administrative burden. Schemes that have developed online capabilities, allowing members to update records, submit online applications and even perform online switching, have limited the amount of manual intervention needed from an administrative perspective. In addition, legislation has now been passed which enables schemes to take further advantage of online media.

However, there are a number of reasons why schemes may not be making full use of the technology available to them:

- Lack of monetary investment on the part of the scheme sponsor
- The trustees/managers or scheme sponsor not being comfortable with allowing members full access to all facilities either for reasons of security or because of doubts concerning the accuracy of member data
- Lack of links between pensions and investment systems to allow straight through processing for switching instructions
- There may be a perception that those without computers or access to the intranet/internet will be disadvantaged

It is vital that schemes recognise and value the use of technology in providing a service to members and for TPAs a service to their clients. This is especially more apparent with the advent of automatic enrolment.

Self Test Questions

- List the reasons why real time switching is not a standard approach
- What are the benefits of STP for a DC scheme
- Explain the process for online enrolment

Part 2

AUTOMATIC ENROLMENT

OVERVIEW

This part comprises three chapters.

It considers the operation of automatic enrolment and the associated regulatory regime.

The first chapter outlines the employer duties for automatic enrolment. Chapter 2 covers NEST and other master trusts. Finally, Chapter 3 explains the role of the Pensions Regulator and its Codes of Practice and other guidance.

CHAPTER 1

EMPLOYER DUTIES

INTRODUCTION

This Chapter sets out employers' duties in relation to automatic enrolment.

In recent decades, the 'demographic time bomb' has undermined the sustainability of the UK's pension system. As a result of increasing longevity, those retiring are drawing pensions for longer, meaning that the cost of providing pensions has increased. At the same time, a declining birth rate has increased the financial burden of unfunded State benefits, which is now spread across a shrinking workforce.

Through the 1990s and early 2000s, there had been a marked tendency for some employees to have no pension provision, other than that provided by the State. The introduction of automatic enrolment in October 2012, was therefore a response to this increasingly serious problem. The legal framework for this was contained in the Pensions Act 2008.

Membership of a workplace pension scheme has now become the default option for many employees. Those who are automatically enrolled and who do not want to participate in a workplace pension scheme have to make a conscious decision to opt out. The result has been that there has been a significant increase in the numbers of people who are making some provision for their retirement. Importantly, for workers, automatic enrolment is not a system of compulsion. Instead, individuals are being 'nudged' into saving for retirement as the conscious decision to join a scheme is no longer required.

The regulations have undoubtedly been a success with take up of pensions in the UK and the assets under management massively increasing. Attention is now turning to improving the situation for employees and laying the framework to extend auto enrolment to other groups of employees previously excluded, and improving the contributions.

In order to cater for employers who did not have the appetite to establish an arrangement suitable for automatic enrolment, the National Employment Savings Trust (NEST) was established. NEST is a low-cost, defined contribution (DC) pension arrangement which is bound by a Public Service Obligation. This guarantees that any employer can use it as an automatic enrolment scheme in order to comply with their obligations arising from the Pensions Act 2008.

To be an automatic enrolment scheme, a scheme must meet the qualifying criteria (set out in the next section) and in addition, it must not contain any provisions that:

- prevent the employer from making the required arrangements to automatically enrol, opt in or re-enrol a jobholder; or
- require the jobholder to express a choice in relation to any matter, or to provide any information, in order to remain an active member of the pension scheme.

In addition, depending on the type of scheme used to comply with the regulations, additional criteria apply, as outlined below.

1.1 QUALIFYING SCHEMES: DEFINED BENEFIT

Before 6 April 2016 for a DB scheme to be treated as a qualifying scheme, it had to either be contracted out on a Reference Scheme Test basis or provide benefits broadly equivalent to, or better than, a 'test scheme' (not to be confused with the Reference Scheme Test used for contracting out) when looked at the relevant membership as a whole. The test scheme is one that gives a pension payable from State Pension Age (or 65 if greater) of 1/120 of final qualifying earnings (averaged over the final 3 years of pensionable service) for each year of service.

It is also possible for a career average revalued earnings (CARE) scheme to be treated as a qualifying scheme if it provides benefits equivalent to the test scheme standard. For CARE schemes, there are requirements as to the minimum level of revaluation that must be given if the scheme is to be a qualifying scheme.

On 1 April 2015, two more 'Alternative DB' routes for meeting the qualifying condition were introduced. These are:

- the cost of accrual test (where the cost of benefit accrual is used to determine whether the scheme qualifies); and
- the shared risk test. A shared risk scheme may test against the minimum contributions for a qualifying DC scheme.

For a transitional period, which ended on 5 April 2019, a scheme-level cost of accruals test was available to employers of schemes that were contracted out on 5 April 2016. This was only available:

- for jobholders who were in contracted out employment on 5 April 2016; and
- the scheme's rules had not been amended so that the contracting out requirements would no longer be met.

If the design of a contracted in DB scheme is similar to that of the test scheme (or the shared risk test applies) it may be possible for the employer itself to certify that the benefits are adequate. Otherwise the scheme actuary will usually provide the necessary certification.

1.2 QUALIFYING SCHEMES: DEFINED CONTRIBUTION

Occupational schemes

For an occupational DC scheme to be treated as a qualifying scheme the following criteria must apply:

- there must be an employer contribution;
- the overall contributions paid must be equivalent to at least 8% of qualifying earnings in the pay reference period;
- the employer must contribute an equivalent of 3% of qualifying earnings in the pay reference period; and
- there must be a default investment fund and the charge for this may be no greater than the equivalent of 0.75% of the value of the fund per annum.

Contract based schemes

The minimum contribution rates and default investment fund charge cap are the same for contract based pension arrangements as for occupational schemes, however the following supervisory criteria must also be met:

- UK schemes must be subject to regulation by the Financial Conduct Authority (FCA);
- operations for UK schemes must be carried out by a person authorised under Section 19 of the Financial Services Market Act 2000;
- defined contribution benefits must be provided;
- there must be a legally binding obligation on the employer to pay minimum contributions in respect of the jobholder to the provider;
- direct payment arrangements must exist for the employer to collect and pay over contributions to the provider.

1.3 OTHER PENSION SCHEMES

An employer may run more than one pension scheme. For example, there may be a separate scheme for entitled workers (see section 1.6 for further explanation) with a lower (or no) employer contribution than the automatic enrolment scheme. Or there may be a second scheme for executives or longer serving employees with higher contributions or different benefits such as DB rather than DC.

These schemes do not have to comply with the automatic enrolment conditions on access to the scheme (i.e. not requiring any action by the employee) but must still meet the qualifying scheme standard unless:

- all of its members are entitled workers, or
- it is a top up scheme which simply provides benefits in addition to those from membership of another qualifying scheme

For such schemes, membership can be by application or automatic enrolment. Some companies may move employees from the automatic enrolment pension scheme into a non-automatic enrolment pension scheme when they become eligible for the 'premium' scheme.

Whether or not an application form is used, employees will need to give some form of written authority for contributions to be deducted from their salary.

1.4 STAGING DATES

The date from which an employer's automatic enrolment duties came into effect is called the staging date and was determined by the employer's Pay As You Earn (PAYE) reference. When automatic enrolment was first introduced, the largest companies with a payroll of 120,000 or more were allocated a staging date of 1 October 2012 and those with between 50,000 and 120,000 staged on 1 November 2012.

From 1 July 2015, when employers with fewer than 30 workers began to stage, the staging date was then determined by the final two characters of the employer's PAYE code. In the case of employers operating more than one PAYE scheme, the staging date was determined by the largest PAYE scheme and will therefore have applied to all of the employer's workers.

Employers who set up their company after 2012 were allocated staging dates between 1 May 2017 and 1 February 2018 depending on the date PAYE income first became payable. The implementation of automatic enrolment for all existing employers as at 30 September 2017 concluded in February 2018.

Employers had the ability to bring forward their staging date so they could have the flexibility to align staging dates if employers within the same group had multiple staging dates, or with some other convenient date or to avoid having to use a date that fell at a particularly busy time for their business.

Employers who set up their company from 1 October 2017 onwards do not have a pre-determined date for their automatic enrolment duties to start. Their 'duties start date' will be the contracted start date of their first worker.

1.5 CATEGORIES OF WORKERS

Most employees are required to be included within the automatic enrolment requirements by default, however some are not included automatically, based principally on age, earnings levels and whether they are ordinarily working in the UK. They may however participate on a voluntary basis.

The Pensions Act 2008 defines employees who are directly impacted by automatic enrolment as 'workers'. A worker is an individual who either:

- has a contract of employment (as opposed to being self-employed); or
- is contracted to provide work and services personally and so is not permitted to sub-contract their duties to a third party.

Ordinarily working in the UK

Firstly, an employer must establish whether a worker is ordinarily working in the UK, which although simple in the majority of cases can be more complicated particularly in the case of multinational groups of companies, when an employee's work takes them outside of the UK on a regular basis.

The most important factor is where the employee is based.

Auto-enrolment duties apply equally to an overseas and a UK registered company, and applies equally to a non-UK national as well as to a UK national, as long as the employee is working or ordinarily working legally in the UK.

An employee who is not working in the UK may be ordinarily working in the UK although the main test is still where the employee is based.

Additional factors to consider are:

- the employee begins and ends their work in the UK;
- their private residence is in the UK;
- they are paid in Pounds Sterling;
- they are paying UK National Insurance contributions;
- their employer's headquarters are located in the UK.

If the employee's contract remains with a UK employer, and there is an expectation of return at the end of the period of Secondment, then the employee will also be ordinarily working in the UK.

Enrolment of 'eligible jobholders'

All 'eligible jobholders' – those between age 22 and State Pension Age (SPA) and earning more than the 'earnings trigger' (£10,000 for 2024/25), who are not already in a suitable qualifying pension scheme, need to be automatically enrolled into a 'qualifying scheme'.

Employees may opt out and be treated as if they had never joined provided they do so within one month of joining (or within one month of being notified about their automatic enrolment, if later).

Those who do opt out will periodically be automatically re-enrolled provided they are still eligible jobholders at that time. The employer must set a date for automatic 're-enrolment' broadly 3 years from their staging date, duties start date or their last re-enrolment date, which 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 each time they are re-enrolled.

Subsequent re-enrolments are then undertaken three years on from the previous re-enrolment date. There is a window of 6 months, three months before and three months after the re-enrolment date, when this can be undertaken.

Qualifying Earnings

Qualifying earnings are gross earnings, between the lower and upper contribution limits. Specifically, the following are included when calculating qualifying earnings:

- basic salary or wages
- commission
- bonuses
- overtime
- Statutory Sick Pay
- Statutory Maternity Pay
- Ordinary or Additional Statutory Paternity Pay; and
- Statutory Adoption Pay

For 2024/25, the qualifying earnings upper and lower limits are £6,240 and £50,270. There is deliberately a significant gap between the earnings trigger and the lower contribution limit in order to avoid individuals who are earning just over the earnings trigger being enrolled into pension schemes only to receive very low contributions.

Pay Reference Periods

The employer must also identify the period over which earnings are to be measured for assessment purposes. This is known at the relevant Pay Reference Period.

There are two definitions for the employer to choose between for the purposes of assessment:

- the earnings period by which the worker is paid, which will generally equate to the frequency with which a worker is paid;
- the tax period, which must be expressed as tax weeks, tax months or some whole multiple of either. The first tax period in any year will always begin on 6 April.

1.6 JOBHOLDERS

Workers are classified into eligible jobholders, non-eligible jobholders and entitled workers, according to their age and earnings as set out below:

CATEGORY	AGE RANGE	ANNUAL EARNINGS	ACTION
Entitled worker (EW)	16-74	Less than lower contribution limit	Inform them they will not be automatically enrolled but can join a scheme (not necessarily qualifying)
Non-eligible jobholder (NEJ)	16-74	Between lower contribution limit and earnings trigger	Inform them they will not be automatically enrolled but can opt into a qualifying scheme
	16-21 and SPA-74	Above earnings trigger	
Eligible jobholder (EJ)	22-SPA	Above earnings trigger	XAutomatically enrol, inform them of this and the procedure if they want to opt out

Employers must assess their workers to establish which category they fall into and, therefore, what action is required.

Non-eligible jobholders do not have to be automatically enrolled into a qualifying scheme, but they have a right to opt in to a qualifying scheme if they want to and must be informed of this in writing. Employers are only required to accept one such opt in from each jobholder in any 12-month period.

The employer must also provide a scheme which entitled workers may join (this scheme can be separate to the Automatic Enrolment scheme as it does not have to be qualifying) and they must be informed of this in writing. However, the employer does not have to contribute anything in respect of them.

Any employees who were Non-Eligible Jobholders or Entitled Workers when they started work must be monitored. As soon as they meet the conditions to be an eligible jobholder (for instance on reaching age 22 or earning above the earnings trigger) they must be automatically enrolled into a qualifying scheme, if they are not already a member of a qualifying scheme. The earnings trigger applies to each pay reference period separately so in practice the £10,000 a year threshold means earning £833 or more in a month for a monthly paid worker or £192 in a week for a weekly paid employee.

If an employee has tax protection due to the level of their pension savings, their employer is allowed to exclude them from the auto enrollment assessment process. This is because if such an employee joins a new pension scheme, they may lose their protection. While the Lifetime Allowance has ben removed, the tax protections introduced in relation to it still exist.

1.7 POSTPONEMENT

Although the staging date or duties start date cannot be deferred, employers are able to operate a 'waiting' or 'postponement' period (up to three months) starting from either the date the staging date or duties start date is reached, the date employment commences (for those who begin employment after the staging date) or the date an individual first meets the criteria to be an eligible jobholder.

Postponement is optional, can be used for some or all employees, and different periods of postponement can be adopted for different employees. During this period, assessment of workers is postponed so eligible jobholders do not need to be automatically enrolled although they must be informed of their right to opt in. If a worker is not an eligible jobholder at the end of the postponement period, monitoring and assessment will need to continue.

Common reasons for employers deciding to use postponement include:

- to avoid automatically enrolling temporary staff whose employment does not last beyond the end of the postponement period
- it allows workers to be re-assessed at a point when earnings are more likely to be representative of typical levels
- high staff turnover
- management of peaks in earnings
- to facilitate payroll processing (e.g. alignment of weekly and monthly pay reference periods)

1.8 CERTIFICATION OF DC SCHEMES

Many existing DC pension schemes base their contributions on total earnings or basic earnings rather than qualifying earnings. Having a different pensionable salary definition could cause considerable practical difficulties when trying to decide whether adequate contributions have been made. To address this, employers may 'certify' periodically that a DC pension scheme that they are using to fulfil their automatic enrolment duties satisfies an 'alternative quality requirement'. This alternative requirement is based on the scheme's own definition of pensionable salary provided that this is no less than the individual's basic pay.

Employers can certify for up to 18 months in advance. They must re-certify at least every 18 months, or sooner if there is a 'significant change' such as:

- a change to the scheme contribution level, or
- company takeovers/mergers

The minimum contributions and available alternative quality requirements are summarised below:

SALARY DEFINITION	MINIMUM TOTAL CONTRIBUTION	MINIMUM EMPLOYER CONTRIBUTION
Qualifying earnings (earnings between £6,240 and £50,270 in 2024/25)	8%	3%
Set 1 – basic pay	9%	4%
Set 2 – basic pay (if basic pay is on aggregate across all members of the scheme at least 85% of total earnings)	8%	3%
Set 3 – gross earnings	7%	3%

For trust-based schemes, the Occupational Pension Schemes (Charges and Governance) regulations 2015 and for contract-based schemes, the FCA's policy statement PS15/5 require that for DC pension schemes:

- the charges that can be levied on the default investment fund in a qualifying scheme from April 2015 are capped at 0.75% p.a. of funds under management.
- Some schemes do not have a simple Annual Management Charge (AMC) type structure – for example the initial charging structure used by NEST (see Part 2, Chapter 4) combines a 0.3% AMC with a 1.8% charge on contributions paid in. Provided that the overall effect of such an arrangement is broadly equivalent to the effect of an annual charge of 0.75% or lower, it will be acceptable.
- the ability to use an Active Member Discount (AMD) in qualifying schemes was removed with effect from April 2016. An AMD is usually a differential charging arrangement under which former employees suffer a higher level of charges than current employees.

1.9 PHASING IN: DEFINED CONTRIBUTION

Minimum contribution requirements were phased in as the Government recognised that the costs of automatic enrolment would impose a financial burden on employers. The full contribution rates (as set out above) did not become payable until 6 April 2019. For the period between the employer's staging date or duties start date and 5 April 2019 the minimum rates of contribution based on Qualifying Earnings were as follows:

PHASING DATES	MINIMUM TOTAL CONTRIBUTION	MINIMUM EMPLOYER CONTRIBUTION
Staging date - 5 April 2018	2%	1%
6 April 2018 - 5 April 2019	5%	2%
6 April 2019 onwards	8%	3%

Similar phasing was also available for schemes using one of these alternative quality requirement tests

Set 1 – basic pay

PHASING DATES	MINIMUM TOTAL CONTRIBUTION	MINIMUM EMPLOYER CONTRIBUTION
Staging date - 5 April 2018	3%	2%
6 April 2018 - 5 April 2019	6%	3%
6 April 2019 onwards	9%	4%

Set 2 – basic pay (if basic pay is on aggregate at least 85% of total earnings)

PHASING DATES	MINIMUM TOTAL CONTRIBUTION	MINIMUM EMPLOYER CONTRIBUTION
Staging date - 5 April 2018	2%	1%
6 April 2018 - 5 April 2019	5%	2%
6 April 2019 onwards	8%	3%

Set 3 – gross earnings

PHASING DATES	MINIMUM TOTAL CONTRIBUTION	MINIMUM EMPLOYER CONTRIBUTION
Staging date - 5 April 2018	2%	1%
6 April 2018 - 5 April 2019	5%	2%
6 April 2019 onwards	7%	3%

1.10 PHASING IN: DEFINED BENEFITS

There were also phasing in arrangements for DB schemes known as the transitional period. The transitional period started with the company's staging date and ended on 30 September 2017. During the transitional period there was no requirement to automatically enrol those existing jobholders who were entitled to join the DB scheme ahead of the company's staging date but did not elect to join.

Those jobholders for whom the transitional period applied retained the right to opt into the arrangement, but would not be auto enrolled until the end of the transitional period. They would have been issued with communications to explain this.

At the end of the transitional period any eligible jobholders for whom the transition period was being used were automatically enrolled into the qualifying DB scheme. Whilst postponement could be used, the notification had to be given immediately, rather than having the 6 week grace period that usually applies (see section 1.12.3 for details of the requirements with regards to communications).

The transitional period would continue to apply through this period as long as certain conditions were met, (chiefly being the right to opt into the DB scheme). If the conditions ceased to be met, then the jobholders would need to be immediately enrolled after the conditions ceased to be met, and to be effective from the original staging date. The scheme used could be either a DB or DC pension scheme.

The transitional period could only be applied to eligible jobholders at the company's staging date. Employers couldn't apply the transitional period to employees meeting the eligible jobholder criteria at a later date, including any they chose to exclude, and any new starters after the staging date. These employees would need to be assessed and if appropriate auto enrolled in the normal manner.

1.11 RE-ENROLMENT

From the point that the automatic enrolment duties apply to a particular employer (i.e. after that employer's staging date or duties start date), 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 opted in or asked to join a scheme.

These two categories of worker are treated differently:

- eligible jobholders who have opted out more than 12 months previously, are automatically reassessed and, if still an eligible jobholder, re-enrolled on the next re-enrolment date. This will take place around the 3-yearly anniversary of an employer's staging date, although it can be up to three months before or after this. Postponement cannot be used with re-enrolment.
- non-eligible jobholders and entitled workers who remain outside the scheme, are assessed each month until they become eligible jobholders (for example reaching age 22 or receiving earnings above the earnings trigger in one pay period), in which case they are automatically enrolled as under the process described above.

1.12 COMMUNICATIONS

One of the employer's duties is to give certain information to their workers within prescribed time limits. The different information requirements for an employer are to give:

- information to eligible jobholders and the trustees, managers or provider of pension schemes as part of the automatic enrolment, re-enrolment and enrolment (opt-in) process
- information to jobholders with a right to opt in and entitled workers with a right to join that explains both the right of a jobholder to opt in to an automatic enrolment scheme and the right of an entitled worker to join a pension scheme.
- information about postponement, where an employer chooses to use postponement
- information about the transitional period for schemes with defined benefits, where an employer chose to use the transitional period

1.12.1 Information for jobholders about being automatically enrolled, automatically re-enrolled or joining

The enrolment information must be given no later than six weeks after the eligible jobholder's automatic enrolment date (in the case of automatic enrolment), or the jobholder's automatic re-enrolment date (in the case of automatic re-enrolment) or enrolment date (in the case of opt-in).

Jobholders must be informed about being enrolled including the date this will occur, the value of any contributions payable and the tax relief available on them. They must also be informed about the right to opt-out, including the process and timescales for doing so, and their right to opt back in.

In addition, where the pension scheme that the employer is using for automatic enrolment is a personal pension scheme, then the employer must also give the jobholder information about the terms and conditions of the personal pension scheme.

1.12.2 Information for workers not being automatically enrolled

A worker who is not being automatically enrolled because they do not meet the eligible jobholder criteria can ask the employer to become a member of a pension scheme at any time. The employer must give a worker information about the right of a non-eligible jobholder to opt in to an automatic enrolment scheme and the right of an entitled worker to join a pension scheme. The information must be given no later than six weeks after the first time the worker becomes either a non-eligible jobholder with a right to opt in or an entitled worker with a right to join.

1.12.3 Information for workers about being postponed

An employer exercises the choice to use postponement in relation to a worker, by giving that worker a notice within 6 weeks of postponement applying. The postponement notice tells a worker that automatic enrolment has been postponed and the date on which it will occur if they continue to meet the criteria. It also informs them of their right to opt in to an automatic enrolment scheme during the postponement period.

1.12.4 Giving information

It is the employer's responsibility to give the statutory information to a worker, and to give the information in writing either in hard copy or information sent by email.

Giving information does not include merely signposting to an internet or intranet site, attaching a URL or displaying a poster in the workplace. In these circumstances, the employer is providing the worker access to the information about the duties but is not giving the actual information.

1.13 COMPLIANCE AND THE PENSIONS REGULATOR

Employers are required to complete a declaration of compliance within 5 months of their staging date or duties start date and subsequent re-enrolment dates. This confirms to The Pensions Regulator (TPR) what they have done to comply with their duties. This also applies when an employer does not have any workforce to enrol into a pension scheme i.e., a nil return is still required.

In addition, employers must evidence or self-certify that the schemes they are using to meet their duties meet the relevant qualifying scheme criteria. This evidence or certificate must be kept by employers for a period of 6 years. Certain records about workers and jobholders, and pension schemes must also be maintained for 6 years (although information about opting out need only be kept for 4 years given the 3 yearly re-enrolment requirements).

One of TPR's statutory objectives under the Pensions Act 2008 is to maximise compliance with the employer duties and employment safeguards under the automatic enrolment regime in the Pensions Act 2004. In its automatic enrolment compliance and enforcement strategy, TPR states that the aim of its strategy is to ensure that employers comply with the automatic enrolment duties, non-compliance is kept to a minimum and workers' pension rights are protected.

TPR believes that most employers will want to meet their automatic enrolment duties. So, their compliance strategy is to educate employers (as well as service providers, advisers and pension providers) to understand the duties and to prompt them into action to prepare for automatic enrolment.

Where an employer fails to comply, either because they have not understood or have not been able to comply, TPR will consider each case on its facts, and if appropriate to do so, they will work with the employer to get them compliant.

TPR has a number of enforcement tools and they have confirmed that they will use all the powers available to them to ensure that they meet their statutory objectives. The enforcement options available to TPR are:

- informal Action to provide assistance to employers to comply.
- statutory powers to request information and enter premises to obtain information. They can also recover unpaid contributions and prohibit someone acting as a trustee.
- statutory notices directing employers and others to take or refrain from taking steps.
- issuing a Fixed Penalty notice of £400 and Escalating Penalty notice of between £50 and £10,000 where there has been a failure to comply with a Statutory notice. Other penalties can also be issued in other circumstances.
- court action in the civil courts to recover unpaid contributions and in the criminal courts to prosecute individuals where there has been willful non-compliance.
- TPR publishes quarterly automatic enrolment compliance and enforcement bulletins, which provide information about any cases and powers they have used relating to automatic enrolment and associated employer duties.

Summary

This Chapter has outlined the employer duties associated with automatic enrolment.

Self Test Questions

- Explain the differences between eligible, non-eligible and entitled workers
- Explain the requirements for a DC scheme to be treated as a qualifying scheme
- Describe the different communication requirements for an employer

CHAPTER 2

NEST AND OTHER MASTER TRUSTS

INTRODUCTION

A multi-employer workplace pension scheme (Master Trust), which was initially known as the Personal Accounts Delivery Authority (or PADA) but was later renamed National Employment Savings Trust (NEST), was established specifically to ensure that smaller employers and low to moderate earners have access to quality pension provision. NEST was established by Section 67 of the Pensions Act 2008 and the National Employment Savings Trust Order 2010. Responsibility for running NEST has been given to the NEST Corporation, a non-departmental public body reporting to the Secretary of State for Work and Pensions (DWP). Since the introduction of the automatic enrolment requirements other Master Trusts have been established to help employers meet their automatic enrolment duties.

2.1 NEST

NEST is effectively a very large multi-employer occupational DC pension scheme. It is one of a number of Master Trust schemes, many of which have been launched specifically with automatic enrolment in mind. Employers participate in these arrangements, but do not actively appoint or remove trustees or have a role in the management of the scheme. Instead the provider operates a trust corporation and appoints third parties to perform functions such as administration and investment.

It is intended to extend the benefits of workplace schemes to those currently without access to them. This has been achieved by establishing a simple, low cost pension scheme which will be available for all employers whether or not they have suitable alternative pension arrangements.

The intention is that the large scale of NEST should mean that the setup 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 will be able to keep their account as they change jobs and can continue to make contributions.

The initial aim was that NEST would complement, rather than compete with, existing high quality pension provision. Because of this, initially there were limitations on transfers in and out of NEST (i.e. members could not transfer a pension entitlement already built up in another pension scheme into their NEST account, or vice versa). There was also an annual limit on contributions that can be paid into a NEST account. These restrictions were lifted in April 2017.

NEST has been successful in attracting employers. As at 31 March 2023, there were 1.1 million employers signed up, and 12 million members (of whom 4.8 million were active), with annual contributions totaling £6.5 billion being paid. There was 29.6 bn of assets under management, which compares with £24.4 bn in 2022, £17.6 bn in 2021 and £9.9 in 2020.

2.2 MASTER TRUSTS

The main features of the operation of a Master Trust are as follows:

- Collection, reconciliation and central functions – a central clearing house is responsible for collecting contributions through employers, handling employer queries, keeping records of contributions and ensuring that contributions are allocated to the right funds.
- Administration of member accounts – the administrator maintains the account for the individual, handles an individual's queries and is responsible for giving them information about their account.
- Investment and fund management – the fund manager invests contributions on behalf of the member.
- Accessing pensions savings - when a member retires, they are able to access their retirement benefits. From 6 April 2015, savers now have more options available to them when they retire as a result of the introduction of the pension freedoms. It is optional for schemes to offer these.

2.3 MASTER TRUST AUTHORISATION

- Master Trusts are now required to comply with duties set out in the Pension Schemes Act 2017. Master Trust authorisation is overseen by TPR. It aims to ensure that Master Trusts continue to run in the best interests of their members.
- From 1 October 2018, Master Trust pension schemes had six months to apply for authorisation from TPR in order to continue operating. Applications for existing Master Trust to apply for authorisation are now closed. All of the applications have been reviewed and the list of those Master Trusts which achieved authorisation can be found online at: **https://www.thepensionsregulator.gov.uk/en/master-trust-pension-schemes/list-of-authorised-master-trusts**
- Those Master Trusts that either did not apply for authorisation or did not obtain approval have been required to exit the market.
- Going forward, all new Master Trusts must apply for, and obtain, authorisation before they can operate.

2.4 EFFECT ON EMPLOYERS

There is strong evidence that automatic enrolment has increased pension scheme take up rates substantially (that is, the percentage of employees who participate in the scheme), whether to an existing pension scheme or to a new arrangement such as NEST.

Although the overall take up rates have increased greatly, they have varied between employers, depending on factors such as what pension arrangements the employer is offering and what the demographic profile of its workforce is.

While the increases in take up rates have had an impact on the employer's pension costs, as the requirements have now been in place for over 10 years, there is an acceptance auto enrolment is here to stay.

Other trends have become apparent, with average contributions falling as employees are often enrolled at the lowest rates, while the inertia that got them to stay in the scheme also means that they don't increase their contributions even if higher contributions are available from the employer.

While the automatic enrolment requirements resulted in additional work for employers when the duties were first rolled out, these processes are now seen as 'business as usual' for organisations, with much of the work being undertaken through the regular payroll processes.

Summary

This Chapter has covered NEST and other master trusts that have emerged to meet the demands of automatic enrolment.

Self Test Questions

- Describe the main features of a Master Trust
- Explain the main characteristics of NEST

CHAPTER 3

THE PENSIONS REGULATOR'S CODES OF PRACTICE AND GUIDANCE NOTES

INTRODUCTION

TPR issues guidance to assist trustees, employers and others in running pension arrangements. There are:

- Codes of Practice intended to give practical guidance on how to comply with the legal requirements of pensions legislation
- Regulatory guidance intended to explain how various aspects of pension provision are regulated
- A dedicated area of TPR's website covering automatic enrolment

3.1 CODES OF PRACTICE (COP)

Historically TPR operated 15 Codes, as outlined below:

#	TOPIC	CONTENT
01	Reporting breaches of the law	Guidance on recording and reporting breaches of the law
02	Notifiable events	TPR must automatically be notified of certain events. Such events are intended to give TPR early warning of a possible call on the PPF. The COP sets out the events which must be notified to TPR
03	Funding defined benefits	Practical guidance to both trustees and employers on how to comply with the Pensions Act 2004 scheme funding requirements
04	Early leavers	Guidance for trustees whose scheme rules do not provide vested rights to members with between three months' and two years' service
05	Reporting late payment of contributions to occupational pension schemes	How trustees of DC occupational schemes should monitor contribution payments and report material payment failures to TPR
06	Reporting late payment of contributions to personal pension schemes	How managers of personal pension schemes should monitor contribution payments and report material payment failures to TPR
07	Trustee knowledge and understanding	Explains the scope of the legal requirements on trustee knowledge and understanding

08	MNT/MND – putting arrangements in place	How to comply with the requirement that at least one- third of the trustee body be member nominated
09	Internal controls	How to meet the legal requirements on internal controls
10	Modification of subsisting rights	Legal requirements for those making scheme modifications
11	Dispute resolution – reasonable periods	Practical examples of reasonable timescales for dispute resolution
12	Circumstances in relation to the material detriment test	Circumstances in which TPR will expect to issue a contribution notice if the material detriment test is met
13	Governance and administration of DC trust-based schemes	Standards of governance and administration for trustees of occupational DC schemes
14	Governance and administration of public service pension schemes	Guidance for management of public service pension schemes
15	Authorisation and supervision of Master Trusts	Provides Master Trusts with the information they need to apply for authorisation.

The COPs are chiefly intended for those concerned with the operation of schemes (as opposed to employers) but not all codes apply to all schemes. For example DC personal pension schemes are covered by COP 06 but many of the other codes will not affect them. In some cases TPR also issues code-related guidance to accompany the codes of practice, explaining TPR's approach in more detail and including information which may need more frequent updating that the codes themselves.

3.2 SINGLE CODE OF PRACTICE

Since March 2024, 10 of the 15 codes have been consolidated into a single code of practice, known as the 'General Code'. The codes which fall outside of the scope of the General Code are 2, 3, 10, 12 and 15.

As well as the consolidation of the various codes, the General Code has introduced new governance responsibilities for trustees of both Defined Benefit and Defined Contribution schemes.

The new code introduced a requirement for trustees to establish and maintain an effective system of governance (ESOG), which should be proportionate to the size, nature and complexity of the scheme.

It should provide the trustees with oversight of the day-to-day operations of the scheme and assurances that the scheme is operating correctly and in accordance with the law, and should include processes and procedures relating to:

- The trustees' policies on meetings and decision-making, remuneration, knowledge and understanding, risk management, conflicts of interest, continuity planning and appointment of advisers and service providers
- Investment governance, including decision-making, investment monitoring, stewardship, and climate change
- Administration, including contributions and financial transactions, scheme data and record-keeping, and IT systems and cyber-security
- Communication and disclosure to members.

Once established, policies should be reviewed at least every three years, to ensure they are functioning as intended.

Own risk assessment (ORA)

The code has also introduced a requirement for trustees of schemes with more than 100 members to carry out and document an own risk assessment (ORA) of how well the ESOG is working, and the way risks are managed.

Schemes will need to start producing an ORA from 2026 at the earliest (although they can produce one earlier) and they will need to be reviewed at least every three years. The ORA will need to be in writing and be signed by the chair. It will need to cover:

- How the trustees assessed the effectiveness of their policies and procedures, and the outcome
- The governing body's policies
- Risk management processes
- Investment governance
- Administration

The ORA must also be provided to TPR on request.

Other new requirements

The General Code also introduces a number of other new requirements:

- Remuneration policy – Trustees should establish a written remuneration policy and review it at least every three years. This should cover those involved in running the scheme or carrying out key functions (including any outsourced providers), but it needs only cover the costs for which the trustees are directly responsible. It should explain the decision-making process for the various principles of remuneration and why they are appropriate, but does not need to set out the actual level of renumeration paid.
- Policy on appointment of advisers and service providers – Trustees should establish a policy covering their approach for the selection, appointment, management and replacement of their advisers and service providers. This should be reviewed every two years.
- ESG and climate change – Trustees should consider Environmental, Social and Governance (ESG) matters in their investment decision-making process. They should document and maintain processes for identifying and assessing climate change risks and opportunities.
- Stewardship – Trustees should identify how to exercise the rights and responsibilities relating to the investments they hold and ensure they are familiar with their investment manager's stewardship policies.
- Data and IT – Trustees should implement policies to ensure scheme data is complete, up to date and held securely. They should also assess and manage cyber risks, including an assessment of service providers' internal controls and cyber security processes. A cyber incident response plan should also be put in place.
- Knowledge and understanding – There are significant updates to the existing Trustee knowledge and understanding code of practice, which are likely to filter through to the trustee toolkit.

3.3 DC CODE OF PRACTICE 13

In November 2013 the DC Code of Practice 13 was brought into effect. This set out 31 quality features that were expected to be present within schemes providing defined contribution benefits, in order to achieve good member outcomes. Whilst compliance was not a legal requirement, trustees were expected to assess their scheme against these quality features and report the findings in an annual governance statement to members.

In April 2015, the Charges and Governance regulations came into force, bringing new legal requirements for trustees to provide an annual Chair's statement, which reports upon key areas of governance, such as value for members, trustee knowledge and understanding and the default investment option, amongst other things. In light of this legislation, the DC Code of Practice was reviewed and, as of 28 July 2016, a new DC Code of Practice came into force.

Whilst the content of the new code was not vastly different from the previous version, there was a considerable effort to make it more accessible.

The Regulator's 31 quality features were replaced by 6 'how to' guides to provide trustees with more practical support on how to achieve compliance in the various areas. The updated code also distinguished between legal requirements and the regulator's expectations, using "the law requires" for the former, and "we expect" for the latter, replacing the more ambiguous "must", "could", and "should" used in the previous COP.

The 6 guides are:

- Trustee board: that the trustee board continues to be suitable and demonstrates honesty and integrity, and manage risks and relationships with advisers and service providers
- Scheme management skills: that the trustees possess adequate knowledge and understanding of DC pension schemes
- Administration: that the administration of DC benefits is conducted efficiently and suitable reports are provided to the trustee board
- Investment governance: that suitable investment options are available, monitored and information is provided to members
- Value for members: that members are provided with adequate value when considering the benefits and services provided with the cost of member-borne charges
- Communicating and reporting: that members are provided with suitable and clear information regarding their DC benefits and the relevant information is reported to the Regulator

While the Code of Practice 13 no longer exists, having been incorporated into the General Code of Practice, the 6 guides remain to provide more detailed guidance specifically relating to the operation and oversight of DC schemes.

The requirements do not apply to:

- schemes providing DB benefits only, or to DB benefits in hybrid schemes,
- work-based personal pensions, stakeholder schemes, or contract-based schemes.

Therefore, DB schemes that have AVCs are covered within the General Code but are not subject to the legal requirement to produce an annual Chair's statement.

The requirements around the Chair's statement have been progressively enhanced since its introduction, in order that they meet the TPR's expectations. The most significant changes have come in for scheme years ending after 31 December 2021, with the requirement that schemes with assets of less than £100 million must now complete a formal value for member assessement, the outcome of which should be recorded in the Chair's statement.

The assessment should include consideration of

- Reported costs and charges (including transaction costs)
- Fund performance
- Scheme governance and administration measures

The review of the costs, charges and performance should be undertaken against three comparison schemes, each with assets of over £100 million, at least one of which the Trustees should have held discussions with to take on the assets.

In order to pass the test, the scheme should deliver charges in line with or lower than, and investment performance in line with or better than, the comparison schemes. If they do not, and there are no mitigating factors, then trustees should conclude that the scheme does not provide good value for members.

For the governance and administration assessment, the key metrics that are to be considered are:

- Promptness and accuracy of core financial transactions
- Quality of record keeping
- Appropriateness of default investment strategy
- Quality of investment governance
- Level of trustee knowledge, understanding and skills to operate the pension scheme effectively
- Quality of communication with scheme members
- Effectiveness of management of conflicts of interest

To demonstrate that a scheme provides good value for members, TPR expects all of these metrics to be met. If any are not, and the shortcomings are not easily addressed then trustees should 'seriously consider the impact' of this.

TPR expects trustees to consider the assessment criteria ahead of completing it, and if trustees determine that the scheme wouldn't pass (i.e. deemed not to provide value for members overall), they should consider whether the necessary changes can be made or look to wind up the DC section. Their view is that if improvements are needed, they should be minor as their clear preference is to wind up.

3.4 REGULATORY GUIDANCE

TPR's regulatory guidance is intended to help trustees, employers and others concerned with pension arrangements to understand what the law requires and the TPR's expectations around pension provision.

TPR has published a number of guidance documents, and they can be found online in their document library here: **https://www.thepensionsregulator.gov.uk/en/document-library**

3.5 AUTOMATIC ENROLMENT

Guidance on automatic enrolment has its own area on TPR's website, and includes:

- A simple step by step guide to help employers meet their responsibilities
- A guide for business advisers to help them guide their clients through the automatic enrolment requirements and the process of setting up and running a new scheme
- Detailed guidance on each aspect of the automatic enrolment requirements:

1. Employer duties and defining the workforce
2. Getting ready
3. Assessing the workforce
   3a. Postponement
   3b. Having completed the assessment
4. Pension schemes
5. Automatic enrolment process
6. Opting in, joining and contractual enrolment
7. Opting out
8. Safeguarding individuals
9. Keeping records
10. Information to workers
11. Automatic re-enrolment

Summary

This Chapter has provided an outline of TPR's COP and regulatory guidance.

Self Test Questions

- Explain the changes introduced by the new single code of practice
- Summarise the areas that the DC Code of Practice 13 focused on.
- List the codes of practice that were incorporated into the General Code, and those that were not.

Part 3

BENEFITS AND COMMUNICATION

OVERVIEW

This part comprises 7 chapters.

It covers all aspects of benefit administration and related communications for all of the benefit options an occupational pension scheme may provide.

The first five chapters cover: leavers; transfers; retirements; deaths; and divorce. Chapter 6 outlines the delivery of pension benefits and finally Chapter 7 covers communications and renewals.

CHAPTER 1

LEAVERS

INTRODUCTION

In this Chapter we will look at the rights and options available to a member who leaves pensionable service before their normal retirement date.

Providing these members or their dependants with the correct benefits and making sure that all the legislative requirements are complied with is a fundamental requirement for a pension scheme.

1.1 EARLY LEAVERS

When an active member leaves pensionable service, the employer must notify the trustees (or, in practice, the administrator) and provide the information needed to calculate the member's benefit entitlement, for example details of their final earnings.

The factors that determine what benefits become payable and in what circumstances are:

- Whether the scheme provides defined benefits or defined contribution benefits
- Whether the member has opted out of the scheme as a result of being automatically enrolled, or enrolled following their request to opt in
- How much 'qualifying service' (see below) the member has completed
- Whether the scheme is contributory or non-contributory for members
- Whether the member has any contracted out benefits in the scheme
- The rules of the scheme, for instance whether early retirement is available

1.2 QUALIFYING SERVICE

Qualifying service broadly means the period of service that is taken into account to calculate the benefits a member is entitled to when they leave the scheme. It includes any period of service before entering the scheme which is classed as pensionable and any service in respect of a transfer value brought in from a previous arrangement (the latter is referred to as 'linked qualifying service').

1.3 OPTIONS ON LEAVING

1.3.1 If the Member is Opting Out During the One-Month Opt Out Period

If an eligible jobholder is automatically enrolled into scheme membership, or a jobholder is enrolled following their request to opt in, they have the right to opt out of the scheme within one month of being enrolled.

If the member exercises this right, they are treated as never having been a member of the scheme and the employer must refund to them any contributions they have paid to the scheme. The employer must generally refund the contributions within one month of receiving the opt out notice from the employee.

If any of the member's contributions have been passed across to the pension scheme, the scheme must refund those contributions to the employer along with any related employer contributions (again generally within one month of the employer receiving the opt out notice from the employee).

1.3.2. If the Member has Less Than Three Months' Qualifying Service in a Defined Benefit Scheme (And is Not Opting Out Within the One-Month Opt Out Period) or has Less Than One Month's Qualifying Service in a DC Scheme

The member is usually only entitled to a refund of their own contributions including any Additional Voluntary Contributions (AVCs) they have paid. This lump sum cannot exceed the amount of the member's contributions to the scheme and is known as a Short Service Refund Lump Sum.

Deductions will usually be taken from the refund as follows:

- Tax at the rate of 20% on the first £20,000 of contributions (including AVCs) repaid and 50% on any contributions (including AVCs) repaid over this amount
- If the scheme was contracted out and the member was in contracted out service under the scheme prior to 6 April 2016, the member's share of the cost of reinstating them in the State Second Pension scheme (as if they had not been contracted out, see below)

Any investment return on AVCs or interest awarded on ordinary contributions may also be paid but must be paid gross. The member must then declare that amount to their local Inspector of Taxes. Tax will be levied directly on the individual. Such a payment is known as a Scheme Administration Member Payment.

It is worth noting at this point that the right to a refund of contributions in these circumstances only applies to members of an occupational pension scheme. Members with personal pension plans, for example, have always been entitled to a short service benefit in the plan instead of a refund regardless of the length of their membership.

If a member has transferred in benefits from a contract-based scheme such as a personal pension plan, they will always have a right to deferred benefits on leaving, whatever their period of qualifying service, and cannot have a refund of their contributions.

1.3.3 If the Scheme was Contracted Out

Where:

- An employee left pensionable service under a scheme which was contracted out and took a refund, and
- The leaving date is before the tax year in which they reach State pension age,

A Contributions Equivalent Premium (CEP) could be paid to the National Insurance Contributions and Employer Office (NIC&EO). This payment:

- Restored the employee's rights in the State pension scheme as if they had not been contracted out, and
- Extinguished their right to any contracted out benefits in the scheme

The CEP represented the employer's and employee's additional National Insurance contributions which would have been paid had the employee not been contracted out. The employee's share of the CEP, which is known as 'the Certified Amount', could be recovered from any refund of employee's contributions.

Following the cessation of contracting out on 6 April 2016, the CEP (and any Certified Amount deducted from refund of contributions) will only reflect the additional National Insurance contributions that would have been paid up to 5 April 2016. For leavers on or after 6th April 2018, no CEPs are therefore payable.

1.3.4 If the Member has Between Three Months' and Two Years' Qualifying Service in a Defined Benefit Scheme

Usually a choice between:

- A refund of the member's own contributions (including any AVCs) which will be paid as described above, or
- Transferring the value of their benefits, known as a cash transfer sum, to another suitable pension arrangement, such as a new employer's scheme or a personal pension scheme

Within three months of the member leaving pensionable service, the trustees must notify them of their right to a refund or a cash transfer sum. Trustees may leave this option open indefinitely or may give the member a reasonable period (usually three months) to request a cash transfer sum. If this is not taken up the option will then lapse and the refund of contributions will be paid instead.

These timescales come from the TPR's Code of Practice on Early Leavers, available from:

http://www.thepensionsregulator.gov.uk/codes/code-early-leavers.aspx

Some schemes may be more generous and offer a deferred benefit to a member with less than two years' qualifying service. Where a deferred pension is offered, the member is not entitled to a cash transfer sum. Instead, they would be entitled to a cash equivalent transfer value.

Again, if the member has brought a transfer into the scheme from a personal pension or, for members with defined contribution (DC) benefits from 1 October 2015, a refund or a cash transfer sum is not available.

1.3.5 If the Member has at Least Two Years' Qualifying Service in a Defined Benefit Scheme or at Least One Month's Qualifying Service in a Defined Contribution Scheme

Under the Pension Schemes Act 1993, such members are entitled to preserved benefits in the form of a deferred benefit within the scheme when they leave.

Where 'preservation' applies, the member has a right to a preserved benefit payable on retirement or death at or after their normal pension age (NPA), in respect of all benefits (excluding lump sum death benefits) earned up to the date of leaving. Schemes may also provide deferred death before retirement pensions, which is not strictly required under preservation requirements (although there may be an obligation to pay certain contracted-out rights).

1.4 PRESERVATION AND DISCLOSURE REGULATIONS

Under The Occupational Pension Schemes (Preservation of Benefit) Regulations 1991/167, members who leave pensionable service with preserved benefits must be provided, automatically, with details of their rights and options under the scheme within two months of the trustees receiving notification of the termination of pensionable service. This includes setting out the member's right to request a transfer value but it does not require a statement of the value to be provided.

The disclosure regulations allow members with deferred benefits to request details of the benefits that would be paid at NPA or on death. If requested, this information must be provided within two months. Having received this information, members are not automatically entitled to request it again free of charge during the next 12 months.

Members can transfer their benefits to another pension scheme or to a suitable insurance policy, personal or stakeholder pension scheme. See Chapter 2 for information on transfers.

1.4.1 If the Member has Contracted Out Rights in the Scheme

If a member has been in pensionable service of a contracted out scheme between 6 April 1978 and 5 April 1997 their accrued rights will include a Guaranteed Minimum Pension (GMP). GMP is payable at GMP payment age, which is 60 for females and 65 for males.

Before 6 April 2016, administrators had to inform NIC&EO where an employee left pensionable service with accrued contracted out rights before the tax year in which they reach their GMP payment age.

NIC&EO would then issue a notice confirming the amount of the GMP.

Following the abolition of contracting out, NIC&EO no longer issue a notice. When an employee leaves pensionable service the trustees and their administrators must rely on their own records (having confirmed these as part of the GMP reconciliation process) to ensure the correct amount of GMP is recorded.

GMP must be revalued from the date contracting out employment ceased up to GMP payment age. The method of GMP revaluation is set out in the scheme rules. Often the rules allow for either of the methods described below and the trustees will have selected one when the scheme started to contract out. It must be the same for all leavers until the trustees elect to change it, the new method will then apply to all leavers from the date of the election.

Members who leave pensionable service during the tax year in which their GMP payment age falls, or the immediately preceding one, do not receive any GMP revaluation.

Contracted out benefits accrued since 6 April 1997 revalue in deferment in the same way as other non GMP benefits.

1.4.2 Revaluation of Deferred Pensions

Under a DB arrangement, the trustees must increase the deferred pension between the date of leaving and retirement as follows:

Revaluation of the GMP Element

The GMP of early leavers must be revalued for each complete tax year between ceasing contracted out employment (although see below), up to GMP payment age or death, if earlier.
For members who terminated contracted out employment on or before 5 April 1997, schemes could revalue GMPs using either:

- Section 148 orders (previously called Section 21 orders) which is known as full rate revaluation
- A fixed rate
- A limited rate (full rate revaluation capped at 5% a year compound)

For members whose GMP is revalued at fixed rate, that rate is set at the time they left contracted out employment as set out in the table below:

DATE CONTRACTED OUT EMPLOYMENT ENDED	FIXED RATE
06/04/1978 – 05/04/1988	8.5%
06/04/1988 – 05/04/1993	7.5%
06/04/1993 – 05/04/1997	7.0%
06/04/1997 – 05/04/2002	6.25%
06/04/2002 – 05/04/2007	4.5%
06/04/2007 – 05/04/2012	4.0%
06/04/2012 – 05/04/2016	4.75%

For example, a member who left contracted out employment in 1994 and who has a GMP subject to fixed rate revaluation, will have their GMP revalued by 7% for each complete tax year up to their GMP payment age.

As the amount of revaluation is capped for schemes that used limited rate revaluation, they had to pay a premium to the state so that the state paid any additional revaluation that may be due. This premium was known as a Limited Revaluation Premium (LRP).

For members who terminate contracted out employment on or after 6 April 1997, schemes may only revalue using either Section 148 orders or a fixed rate. Schemes which used limited rate revaluation before 6 April 1997 had to change to either full or fixed rate revaluation for leavers from then onwards. Limited rate revaluation can continue to apply for those members who left the scheme before 6 April 1997.

With the cessation of contracting out from 6 April 2016, any active members stopped being contracted out on 5 April 2016. For some schemes their rules refer to GMP revaluation applying from the date contracted out service ended. This would mean that schemes may find they are providing a higher benefit than necessary (e.g. revaluing GMP at Fixed rate from 5 April 2016, rather than from the date they left pensionable service). Trustees were therefore given a one-year window to amend their scheme provisions to link the revaluation a member's GMP benefits to the date the member eventually leaves pensionable service rather than 5 April 2016.

DATE LEFT PENSIONABLE SERVICE OF A SCHEME WHICH WAS CONTRACTED OUT ON 5 APRIL 2016	FIXED RATE
06/04/2016 – 05/04/2017	4.75%
06/04/2017 –	3.5%
06/04/2022 – 05/04/2027	3.25%

1.4.3 Anti-franking

The GMPs of early leavers are protected by anti-franking legislation. The basic principle is that any pension in excess of the GMP is not eroded by using it to offset the revaluation of the GMP. Therefore, for someone retiring at their NPA, the minimum pension payable at the member's GMP payment age under the anti-franking rules is broadly the aggregate of the following:

- The pension rights accrued by the member at the time of ceasing to contract out
- The amount by which the GMP has increased between the date contracting out ended and the date of payment
- Any pension earned whilst contracted in

Statutory revaluation on benefits in excess of the GMP (see below) must be paid in addition.

1.4.4 Non GMP

Different rules apply to non GMP benefits, which:

- For a scheme which was previously contracted out, include
  - Pension accrued prior to 6 April 1997, in excess of GMP
  - Pension accrued from 6 April 1997 to 5 April 2016 on the reference scheme test basis
- For a scheme that was not contracted out, all pension

If a member leaves pensionable service at least one full year before NPA, the Pension Schemes Act 1993 requires that the deferred benefit, in excess of the GMP, is revalued up to NPA. The revaluation method depends on the nature of the scheme.

For members who leave pensionable service on or after 1 January 1991, all of the deferred benefit in excess of the GMP must be revalued. Those members who left pensionable service prior to 1 January 1986 do not have to have their benefit in excess of the GMP revalued and for those who left pensionable service between 1 January 1986 and 31 December 1990, only that part of the excess benefit earned after 31 December 1984 has to be revalued.

For defined benefit schemes, deferred benefits subject to revaluation must be increased as follows:

- The deferred benefit accrued prior to 6 April 2009 must be increased for each complete year between leaving pensionable service and NPA by the lower of the rise in prices over the period and 5% a year compound
- The deferred benefit accrued after 5 April 2009 must be increased for each complete year between leaving pensionable service and NPA by the lower of the rise in prices over the period and 2.5% a year compound

Up to 1 January 2011, the rise in prices was measured using the Retail Prices Index (RPI). After this date, the Consumer Prices Index (CPI) is used.

Note that the above are minimum revaluation requirements and some schemes may provide higher revaluation levels. For instance, some schemes:

- Will still apply the 5% cap to benefits accrued after 5 April 2009 or adopt the lower rate at a later date, or
- Continue to use RPI instead of CPI as the measure for price inflation for some or all of the member's benefits

For Career Average Revalued Earnings schemes, the revaluation requirement under the Pension Schemes Act 1993 is met by either:

- Revaluing deferred benefits as set out above.
- Revaluing the salaries for deferred members in the same way that would have applied if the member had continued to be in active service

For DC arrangements there is no minimum level of revaluation that should be applied. Any revaluation will be solely down to any investment returns on the member's pot up to the date they take their benefits.

1.4.5 Leaving Pensionable Service (Outside of the Opt Out Period Where the Scheme is Being Used as an Automatic Enrolment Scheme) Without Leaving Employment

The Social Security Act 1986 gave employees the right to cease active membership of their employer's scheme at any time from 6 April 1988 without leaving employment. The scheme may impose certain conditions, such as the period of notice which the employee must give before leaving pensionable service (which may be up to three months) and the terms for re-joining in the future. The Employer may need to (re-)enrol the member into a qualifying pension scheme at their next automatic re-enrolment date.

Leavers in this category have a statutory right to transfer out any part of their entitlement which was earned after 5 April 1988 (entitlement earned before 6 April 1988 can be transferred once they leave the company's employment). It is likely, however, that the scheme rules will be more generous and allow the transfer of the whole benefit without the member leaving employment.

1.5 PAYMENT OF DEFERRED PENSIONS AT NORMAL PENSION AGE

Typically, the scheme will send a letter to the member's last known address four to six months before NPA. If the member does not respond, other attempts can be made to get in touch e.g. through the employing company's records, former colleagues, the DWP letter forwarding service, specialist tracing agencies etc.

If all this proves unsuccessful then the pension can be held in suspense until the member makes contact or a periodic review of suspended cases proves successful. Once contact has been made procedures will be similar to those for an active member but the following points should be kept in mind:

- The terms attaching to the pension might be governed by the scheme rules in force when the member left pensionable service, e.g. the eligibility for an automatic dependant's pension
- Some proof of identity should be obtained to ensure contact has been made with the correct individual

If a deferred benefit is not claimed within six years of entitlement arising, the scheme's rules may provide that the back payments due for periods more than six years ago may be forfeited, but not the right to the last six years' instalments or any future instalments. The rules may also give the trustees discretion to allow back payments due for periods more than six years ago to be paid in any event.

The same disclosure requirements apply when retiring from deferred status as apply when retiring from active membership.

The problem for occupational schemes in tracing members with deferred pensions was discussed above. A similar problem applies to members with deferred pensions who cannot trace the body responsible for paying their deferred pension. This can be for a number of reasons, such as company take-overs, mergers, liquidations, changes of names etc. Members can use the Pensions Tracing Service (operated by the Department for Work and Pensions – see https://www.gov.uk/find-pension-contact-details) to trace former pension schemes.

1.6 PAYMENT OF DEFERRED PENSION AT OTHER TIMES

Members will generally have the option under the scheme rules to take their pension early or possibly to postpone it beyond NPA. This is usually subject to the consent of the trustees and may be subject to additional requirements such as still being in employment if the member wishes to postpone taking their pension. The pension will normally be reduced or increased for early or late payment respectively.

1.7 DEATH OF A DEFERRED MEMBER

The scheme rules may provide for the payment of a dependant's pension if the member dies after leaving pensionable service and before the deferred pension comes into payment. If the scheme is contracted out:

- Widows must receive a GMP in respect of all contracted out service prior to 6 April 1997, and a pension in respect of contracted out service from 6 April 1997
- Widowers (including widowers from same sex marriages), widows of female members under a same sex marriage and surviving civil partners must receive a GMP in respect of contracted out service between 6 April 1988 and 5 April 1997, and a pension in respect of contracted out service from 6 April 1997

Where GMPs have been converted to normal scheme benefits, survivors' benefits must be provided from the converted benefits in the same circumstances and for the same service periods that would have applied had the GMP not been converted.

Summary

When an individual leaves pensionable service, various factors determine what benefits will be payable, if any. All leavers with at least two years' qualifying service are entitled to a preserved benefit on leaving.

Under a DB arrangement, the trustees must increase deferred pensions between the date of leaving and retirement. The rate at which they are increased depends on the type of benefit when the member left pensionable service and whether the scheme revalues pensions in line with the statutory requirements or at a higher rate.

For DC benefits, the member's defined contributions pot will continue to be invested and have charges deducted as appropriate. The benefits the member will receive will depend on the level of investment return and charges deducted.

If a deferred member with contracted out benefits dies in deferment, a pension must be provided for the member's widow, widower, surviving civil partner or widow/widower from a same sex marriage.

Schemes may provide more than this statutory minimum.

Self Test Questions

- Describe the process for bringing the benefits of a deferred member into payment when they reach NPA.
- Explain the basic principle of the anti-franking legislation.
- List the various options a member has when they leave a scheme.
- Distinguish between fixed rate revaluation and limited revaluation for the GMP element of a deferred pension.

CHAPTER 2

TRANSFERS

INTRODUCTION

This Chapter explores the administrative requirements associated with transfers of benefits.

2.1 TRANSFERS IN

Schemes may allow members to transfer in benefits from a previous pension arrangement.

Transfers into defined benefit (DB) schemes on a defined benefit basis are very unusual nowadays, and typically either provide the member with a fixed amount of pension in the receiving scheme or a period of additional pensionable service, which is taken into account when calculating benefits when they eventually leave the scheme.

Transfers into DC schemes will typically provide an increase in the member's fund value, which will represent the transfer value received from the previous scheme.

In general, administrators deal directly with the previous arrangement in order to facilitate transfers effectively and efficiently on the member's behalf. The receiving arrangement will obtain explicit authority from the member in order to do so and correspond directly with their previous arrangement.

Care must be taken to ensure that the receiving scheme can accept the benefits to be transferred. Following the abolition of contracting out on a DC basis, it became possible for DC schemes to accept former protected rights without restriction. In addition, legislation was brought in to allow DC schemes to accept GMPs and benefits in respect of contracted-out service from 6 April 1997 providing certain safeguards are met, and that the scheme rules allow.

The information required from the transferring arrangement will typically include:

- The member's personal details
- The name of the transferring scheme
- The type of arrangement (e.g. DB scheme, personal pension)
- Whether any contracted out benefits are included in the transfer value
- Pensionable service details
- Whether the transfer contains a transfer in from a previous scheme and, if so, details of this
- Value of member's benefits and contributions included in transfer, including any AVCs
- Current transfer value and whether any guarantee period applies
- Statement of equalisation for pensionable service post 17 May 1990 (if applicable). This should include a statement regarding the extent to which GMPs have been equalised.
- Confirmation of any court orders on the member's benefits (for example Earmarking or Pension Sharing Orders, maintenance or bankruptcy orders)

When the administrator of the receiving scheme has all the necessary information, an illustration of the benefits to be provided in the new scheme will be forwarded to the member, together with instructions on what the member should do if they wish to proceed with the transfer. If the transfer includes contracted out benefits, then an explanation of what these benefits provide will need to be included within the illustration.

Whilst the value of the benefits transferred from a DB scheme will be guaranteed for a period (normally six months from the date of the original calculation provided the transfer is formally accepted within three months), transfers between DC schemes are not guaranteed, as the value of the units to be sold/purchased will vary according to market conditions at the time of transfer. This should also be brought to the member's attention by the transferring scheme.

If the member decides to proceed with the transfer in, they will be required by the receiving scheme to complete a discharge form, which will also include an authority for the administrator to instruct the previous pension arrangement to transfer the member's benefit to the new scheme. The receiving scheme will have to provide evidence that they are a registered pension arrangement with HMRC and provide payment instructions.

On receipt of the transfer monies, particularly when the member is to be awarded DC benefits in respect of the transfer, it is important for the administrator of the receiving scheme to undertake prompt investment of the transfer amount, so that the member does not suffer any potential financial loss; for example, if investment returns are favourable whilst the transfer monies are being held in cash.

Full details of the transfer will need to be entered on the member's record, and the part of the transfer value representing the employee contributions should be separately identified. This will also help if the member subsequently leaves the receiving scheme and decides, at a later date, to transfer out all of his/her benefits (including the existing transferred in benefit) to another registered pension arrangement.

2.2 TRANSFERS OUT

Members who leave a pension scheme before retirement usually have the right to transfer the value of their benefits to another pension arrangement. The amount transferred is called the 'cash equivalent transfer value' of the member's benefits.

The right to transfer their benefits to another suitable pension arrangement depends on the type of benefits the member has in the transferring scheme as different rules apply.

2.2.1 Members with Defined Benefits

Members with defined benefits (also known as safeguarded benefits in this context) who leave pensionable service at least one year before their NPA with a deferred benefit in the scheme have a statutory right to request a statement of the 'cash equivalent transfer value' of their deferred benefits that could be available to transfer to another suitable pension arrangement.

There is no statutory right to transfer rights earned under an occupational pension scheme before 6 April 1988, if the member leaves pensionable service without leaving employment.

The scheme rules may allow members to transfer their benefits even where they do not have a statutory right to do so. Given the pension freedom available to individuals with defined contribution pots, some schemes may now offer or provide details of a member's cash equivalent transfer value alongside retirement quotations.

Where a member wishes to transfer their DB pension to a pension arrangement that provides flexible benefits (i.e. a DC arrangement, such as a personal pension plan) and the transfer value (before any reduction to reflect the funding position of the scheme) is over £30,000, the member will have to have obtained Appropriate Independent Advice regarding the proposed transfer.

Before making a transfer payment, the Trustees (or more likely the administrators, on their behalf) must check that the member has received that advice.

In addition, for transfers requested on or after 30 November 2021, under the Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021, the trustees of the transferring scheme must carry out due diligence on the receiving arrangement and have the right to refuse a transfer if certain amber or red flags are present. Some transfers (for example transfers to certain public sector schemes, authorised master trusts or authorised collective defined contribution schemes) can proceed with minimal checks. For other transfers, the trustees must carry out additional checks in relation to the receiving scheme and, in respect of transfers to occupational pension schemes, check that there is a valid employment link to the new scheme.

Members with public sector DB pensions cannot transfer their pension benefits to another pension arrangement providing flexible benefits.

2.2.2 Members with Defined Contribution Benefits or Other Flexible Benefits (i.e. a Cash Balance Pension)

Members with DC or other flexible benefits also have a statutory right to transfer their benefits to another suitable pension arrangement. The right to transfer applies right up to the point the benefits are taken.

Where a form of guarantee is provided, the benefit will fall into the safeguarded benefit category and the transfer would therefore be subject to the advice requirement. Examples of safeguarded benefits in a DC scheme are where the pre 97 fund has a GMP underpin, the post 97 fund is subject to the Reference Scheme Test underpin, or where there are guaranteed annuity rates available at retirement.

The requirements set out in Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021 discussed in the previous section also apply to transfers of DC benefits.

2.2.3 Members with More Than One Benefit Type

If a member has more than one benefit type in a scheme, such as a defined benefit pension plus DC AVCs, they have a separate right to transfer the benefits from the different categories.

For example, a member could transfer their defined benefit pension and leave the DC benefits in the scheme, or could transfer their cash balance benefits and leave their defined benefit and DC benefits in the scheme.

However, the statutory right applies to all benefits within the same category. A member with DC AVCs and a DC section has to transfer out all DC benefits together, unless the scheme rules allow partial transfers.

2.2.4 Transferring Contracted Out Benefits

Where contracted out benefits are transferred, unless those rights are being transferred to another former contracted out scheme, the member will need to confirm in writing to the transferring scheme that they:

- Have received a statement from the receiving scheme showing the benefits to be awarded
- Accept that the benefits may differ in amount and form
- Understand that there is no requirement for the receiving scheme to provide survivors' benefits in respect of the transfer payment.

2.2.5 Transfers to an Overseas Pension Arrangement

An overseas pension transfer is broadly similar to a transfer to another UK registered pension scheme with the additional requirements that the overseas arrangement is a Qualifying Recognised Overseas Pension Scheme (QROPS) and that a test against the member's available Overseas Transfer Allowance (OTA) takes place. In addition, any transfers requested on or after 9 March 2017 may be subject to an Overseas Transfer Charge (see below). If the transfer includes contracted-out benefits, there are further requirements which must be satisfied.

To become a QROPS the overseas scheme must make certain declarations and undertakings to HMRC.

It is extremely unlikely that schemes will allow a transfer to be paid to an overseas arrangement which is not a QROPS because:

- A member does not have a statutory right to transfer to an overseas pension scheme which is not a QROPS, so any such transfer made would be paid on a discretionary basis and subject to the provisions of the scheme rules
- Any such transfer would be an unauthorised payment and would be subject to a tax charge both on the scheme and the member

The member will need to complete a declaration to enable the administrator to determine the member's available OTA.

Before the transfer is completed the member must sign a declaration acknowledging that there are circumstances where they may have to pay UK tax on the transfer or on a later payment from the overseas scheme even if they are not resident in the UK.

If the value of the member's benefits exceeds their available OTA, the overseas transfer charge of 25% on the excess must be deducted from the transfer value and accounted for in the next quarterly Accounting for Tax return to HMRC. Details of all overseas transfers must also be reported to HMRC within 60 days of the transfer being made.

If the member has relied on fixed, individual or enhanced protection to avoid or reduce a tax charge on a transfer to a QROPS, this must also be reported on the scheme's annual event report.

Overseas Transfer Charge

Any transfers to a QROPS requested on or after 9 March 2017 are potentially subject to an Overseas Transfer Charge of 25% on either:

- the total transfer value if one of the exemptions set out in legislation is not met, or
- the CETV amount that exceeds their available OTA.
- The transfer is exempt from the Overseas Transfer Charge if any of the following conditions are met;
- The member is resident for tax purposes in the same country in which the QROPS is based;
- The member is resident for tax purposes in the EEA and the QROPS is based in the EEA;
- The QROPS is an occupational pension scheme and the member is an employee of a participating employer and is participating in that scheme as a result of that employment;
- The QROPS is a scheme in respect of an international organisation (for example the European Union) and the member is an employee of a participating employer and is participating in that scheme as a result of that employment; or
- The QROPS is an overseas public service pension scheme and the member is an employee of a participating employer and is participating in that scheme as a result of that employment.

Scheme administrators should check whether any exemptions apply before making the transfer payment.

If none of the exemptions apply, then the Overseas Transfer Charge is payable. The administrator must deduct the charge prior to paying the transfer to the QROPS and pay the charge to HMRC via the quarterly Accounting For Tax return.

Where one of the exemptions applies the administrator of the transferring scheme must inform the member and the receiving QROPS and set out which exemption has been met.

If an Overseas Transfer Charge was not payable due to the member being a tax resident either in the same country as the QROPS, or in the EEA while the QROPS is also based in the EEA, and the member's status changes before the end of five complete tax years following the transfer, then the charge will then become payable. Conversely, if none of the exemptions applied at the time of the original transfer, and a charge was paid, but the member subsequently became resident in a country which means that one of the exemptions would apply, then HMRC will refund the Overseas Transfer Charge. In order for the refund to be paid, the change in residency must occur prior to the end of the fifth complete tax year following the original transfer.

2.3 STATUTORY DISCHARGE

Where a member exercises their statutory right to a transfer, the trustees of the transferring scheme have a full statutory discharge, so that they are not required to provide the member with any benefits to which the cash equivalent related, so long as the receiving arrangement satisfies prescribed requirements. The exact requirements vary depending on whether the receiving arrangement is an occupational scheme, a personal pension or a buy-out policy.

A member with a statutory right to a transfer can split the cash equivalent between as many occupational pension schemes, buy out policies and personal pension arrangements as they wish although, generally, for the statutory discharge to apply, all of the value in respect of that benefit type must be transferred.

Where the member's benefits include any contracted out elements, there are some additional requirements that must be met. If the receiving scheme is also a former contracted-out scheme then, provided it protects the transferred contracted out rights (i.e. continues to treat any GMP benefit as GMP following the transfer), the transfer can be made without any additional requirements.

Alternatively, contracted-out rights can be transferred to a scheme that was never contracted-out provided the member consents in writing to the transfer and confirms in writing that they;

- have received a statement from the receiving scheme setting out the benefits they will receive;
- acknowledge that the benefits in the receiving scheme may be in a different form and amount to those which would have been payable in the transferring scheme; and
- acknowledge that there is no statutory requirement for the receiving scheme to provide for survivors benefits out of the transfer value.

If trustees allow a member to transfer their benefits where a statutory right does not exist, the trustees do not have a statutory discharge of their liability to provide benefits for the member. In these cases, trustees will usually insist that the member completes a form to acknowledge that the trustees will no longer be obliged to provide benefits for them.

2.4 NOTIFYING NIC&EO OF THE TRANSFER OF CONTRACTED OUT BENEFITS

Following the cessation of contracting out on 6 April 2016 it is no longer necessary to notify NIC&EO that a member's contracted-out benefits have been transferred.

2.5 HMRC REQUIREMENTS

When a member transfers benefits, they will lose their right to enhanced protection, fixed protection 2012, fixed protection 2014 or fixed protection 2016 unless the transfer is a permitted transfer. A transfer will be a permitted transfer if it is a transfer to a DC arrangement or, in limited circumstances, a transfer to a DB arrangement.

Similarly, when a member transfers benefits they will lose their right to a protected pension age of below 55 or rights to a 'grandfathered' Pension Commencement Lump Sum (PCLS) (i.e. a PCLS of more than 25% of the value of the member's benefits) unless the transfer is part of a block transfer, which is the transfer of benefits for more than one member as a single transaction.

A transfer from a registered pension scheme to another registered pension scheme is a recognised transfer under the Finance Act 2004. No tax charges or sanctions apply to recognised transfers. A recognised transfer from one registered pension scheme to another is not a Relevant Benefit Crystallisation Event (RBCE).

Treatment of the value transferred for the purpose of the member's pension input amount (PIA) calculation for the tax year in which the transfer takes place is as follows:

- Where the transferring scheme is one under which the member has a DB arrangement, the value of the benefits transferred in the pension input period (calculated as sixteen times the annual pension entitlement, plus any separate lump sum entitlement) is included in the member's closing value in that arrangement (so it is added back in at its value at the time of the transfer)
- Where the receiving scheme is one under which the member has a DB arrangement, the value of the benefits arising from the transfer payment in the pension input period is deducted from the member's closing value in the arrangement (so it is subtracted at its value at the time of the transfer). For future pension input periods, the transferred in benefits would be included in both the opening and closing benefits under the receiving scheme

A transfer from a registered pension scheme to a non-registered scheme is not a recognised transfer. It is an unauthorised payment and will lead to tax charges against the member and the trustees of the transferring scheme. Members do not have a statutory right to a transfer that is not a recognised transfer, so any such transfers would only be paid at the discretion of the trustees and in accordance with the provisions of the scheme rules.

2.6 CALCULATION AND PAYMENT OF TRANSFER VALUES

The trustees of registered pension schemes are responsible for determining the basis for calculating transfer values, and the assumptions used in DB transfer calculations, after taking advice from their actuary. This responsibility applies not only to cash equivalent transfer values, but also to cash transfer sums for short service leavers, valuations of benefits for divorce purposes and other transfer values for members who do not have a statutory right to transfer their benefits.

Trustees are also responsible for determining how to calculate benefits on a transfer into the scheme.

The transfer values legislation (The Occupational Pension Schemes (Transfer Values) Regulations 1996/1847) requires trustees to calculate an 'initial cash equivalent'. This is the minimum cash equivalent, calculated using a prescribed approach, before any reductions are applied. The final 'cash equivalent' may be either:

a. The initial cash equivalent minus any reduction (where the trustees have decided to reduce transfer values due to the scheme being underfunded), or
b. An alternative cash equivalent, provided this is higher than (a) above

The initial cash equivalent must be calculated using an 'actuarial basis' and must represent 'the amount at the guarantee date which is required to make provision within the scheme for a member's accrued benefits, options and discretionary benefits'.

When a member requests a statement of their cash equivalent transfer value, a calculation of their cash equivalent must be made with an effective date no later than three months after the date of the request. The effective date is known as the guarantee date. Where, for reasons beyond their control, the trustees are unable to calculate the transfer value within the three months, the time limit may be extended for up to a further three months.

A written 'statement of entitlement' must be issued to the member by the guarantee date, which is the period of ten days (excluding Saturdays, Sundays, Christmas Day, New Year's Day and Good Friday) ending on the date on which the statement of entitlement is provided to the member. The statement of entitlement must include a statement of the guaranteed cash equivalent and the guarantee date.

For DC benefits, the transfer value is typically the value of the member's pot at the time the transfer is made. The amount is not guaranteed in these circumstances.

If a member exercises his/her statutory right to a transfer payment (by making a formal written application to the trustees) within three months of the guarantee date, the guaranteed cash equivalent must be paid within six months of the guarantee date.

It is essential that administrators maintain accurate records of the destinations of transfer payments. This prevents discrepancies on retirement when members attempt to trace their benefits but do not recall transfers. Administrators must also ensure they receive the relevant confirmation from the receiving arrangement, certifying that they meet the statutory criteria, to ensure that the trustees receive the statutory discharge.

TPR now asks for information about transfer payments made in the Scheme Return.

2.7 AVOIDING TRANSFERS TO 'PENSION SCAM' SCHEMES

Both TPR and HMRC have become increasingly concerned about the number of transfers to 'pension scam' schemes. These are schemes which, although apparently operating as normal registered pension schemes, nonetheless give members early access to their pension savings, for example in the form of

a loan or cash payment, in breach of HMRC rules or are used as a vehicle for high risk, unregulated, investments. Such arrangements may result in unauthorised payment charges on the member and could result in the member losing most of his or her pension savings.

To help administrators and trustees to detect and deter such transfers, TPR has provided guidance for trustees together with materials for them to use when communicating with members. These can be found on TPR's website at:

http://www.thepensionsregulator.gov.uk/trustees/pension-scams-trustees.aspx

TPR expects trustees and administrators to issue these materials to members' who enquire about a transfer.

In response to concerns that it is too easy to register a pension scheme that might be used to facilitate a scam, HMRC has tightened up its registration process for new schemes by moving away from a 'process now, check later' approach. Scheme registration is no longer confirmed on successful submission of the online form - instead HMRC conducts a risk assessment before determining whether or not to register the scheme. HMRC has also been given broader powers in relation to the registration and de-registration of schemes to prevent pension scams.

As discussed in section 2.2.1 and 2.2.2, to increase the trustee's ability to help protect member's benefits, the Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021 came into force with effect from 30 November 2021. These require trustees to carry out additional due diligence on the receiving arrangement. If this identifies certain amber or red flags suggesting that the receiving scheme may be part of a pension scam, the trustees will have the power to refuse to transfer a member's benefit.

The Pensions Administration Standards Association (PASA) has developed a Code of Practice on due diligence, to help trustees and administrators when dealing with requests for a transfer of benefits.

2.8 RECORDS FOR LEAVERS

When members leave pensionable service with an entitlement to a deferred benefit, schemes must keep additional records to those already kept during their active membership, to ensure that revaluation on any DB pension up to the date of payment is correctly applied, for example:

- any GMP in respect of pre 6 April 1997 contracted-out service (split between GMP earned before and after 6 April 1988)
- any excess pension earned before 6 April 1997 split between those elements that are subject to compulsory revaluation and those that are not (see section 1.4.4 above)
- any pension earned from 6 April 1997 to 5 April 2005
- any pension earned from 6 April 2005 to 5 April 2009
- any pension earned from 5 April 2009 to 5 April 2016
- any pension earned after 5 April 2016

If a member transfers out or takes a refund of contributions, records must be kept of how much was paid and when and, in the case of a transfer, details of the receiving arrangement.

Summary

Members who leave pensionable service before retirement usually have the right to transfer the value of their benefits to another pension arrangement. How the transfer value is calculated is determined by The Occupational Pension Schemes (Transfer Values) Regulations 1996/1847.

If a member exercises their statutory right to take a transfer value, the transfer must be completed within a specified timeframe. A transfer from one UK registered scheme to another is not a BCE.

A lifetime allowance check must be carried out before a transfer to a Qualifying Recognised Overseas Pension Scheme (QROPS) is made because such a transfer is a BCE. There may also be an Overseas Transfer Charge payable.

Self Test Questions

- Outline the steps being taken to combat transfers to pension scam schemes.
- List the information a transferring arrangement will need to provide when a member is transferring benefits into the scheme.
- Briefly describe the process of transferring benefits to an overseas scheme.

CHAPTER 3

RETIREMENTS

INTRODUCTION

The main function of a pension scheme is to provide benefits for and in respect of members, so it is important to understand the range of benefits that may be available.

This Chapter sets out the types of benefits that might be payable on the retirement of a scheme member and how to comply with the necessary legislative requirements.

Not all benefits are available under every pension scheme and the availability of some options depends on the type of benefits the member has accrued.

3.1 RETIREMENTS

Pension schemes will typically have a specified 'normal pension age' (NPA) which is the age at which members are expected to start receiving their pension. Members may, however, retire earlier or later than this age.

Following the abolition of the default retirement age from 1 October 2011, employers cannot automatically retire employees from employment at a predetermined retirement age. This may have affected how pension schemes set their NPA and in turn the calculation of early and late retirement pensions.

We will look at the position for retirements at NPA first, and then consider the additional issues that might apply when retirement is from a different age.

Two main types of pension must be distinguished for this part:

- A scheme pension, meaning a pension provided from an employer's DB or DC arrangements or by an insurance company selected by the trustees. Where DC benefits are involved, the trustees must have given the member the opportunity to have a lifetime annuity instead
- A lifetime annuity, (an annuity contract purchased from an insurance company) from DC arrangements only

In addition, the Finance Act 2014 introduced a number of additional options that could be made available to members of pension schemes with DC benefits (this includes any benefits arising from a member's Additional Voluntary Contributions (AVCs) that provide DC benefits). These came into force with effect from 6 April 2015.

The Occupational and Personal Pension Schemes (Disclosure of Information) (Requirement to Refer Members to Guidance etc) (Amendment) Regulations 2022, were laid before Parliament on 17 January 2022 and introduce the "stronger nudge" requirement with effect from 1 June 2022. This will require trustees of schemes that provide any flexible benefits (including where a member of a defined benefit scheme has additional voluntary contributions on a defined contribution basis) to signpost them to Pension Wise for guidance and facilitate the booking of appointments on behalf of the member if required.

3.2 RETIREMENT AT NORMAL PENSION AGE

When a member is approaching their Normal Pension Age (NPA) the administrator should write to the member to let them know what options are available from the scheme. Where the member has any DC benefits, this should be at least four months before the member's retirement date.

A member's actual retirement benefits may depend on his/her pensionable earnings at or shortly before retirement (for DB arrangements) and, for DC arrangements, the contributions paid to up to retirement and the value of the retirement pot at the time.

Where retirement figures are provided in the run up to retirement, the quotation should make clear that the final benefits payable might change.

The options that are available to the member depend on the scheme rules and also on the type of benefits the member has. These can include:

- A Scheme Pension (see 3.4.1)
- A Lifetime Annuity (see 3.4.2)
- A Pension Commencement Lump Sum (PCLS) (see 3.7)
- Trivial Commutation Lump Sum (see 3.8)
- Small Lump Sum (see 3.8)
- Income Drawdown (see 3.6.1)
- Uncrystallised Funds Pension Lump Sum (see 3.6.3)

The Money and Pensions Service produces a helpful booklet 'Your pension: your choices' that schemes can use to meet their obligations to let members with DC benefits know about the various options.

Where the member has any flexible benefits, that is any benefits from a DC arrangement (including AVCs) or Cash Balance benefits, the member must also be told about a free guidance service known as Pension Wise. This service was set up by the Government and provided by The Money and Pensions Service. The guidance can be either face to face or by telephone and is intended to help members understand the options they have available in respect of their DC benefits.

Once the member has decided on the type of benefits they want, they should be given generic risk warnings about the retirement options available (where the member has flexible benefits) and the administrator should also tell the member what actions he/she needs to take to enable the benefits to be paid. For example:

- Confirming which benefits he/she requires
- Completion of a bank mandate to enable the benefits to be paid to the member's bank account (if benefits are to paid from the scheme)
- Completion of a declaration confirming whether they have previously crystallised (taken) any pension benefits from other registered pension schemes, or whether they will do so before or on the same day as they take benefits from this scheme
- Completion of any documents needed by the scheme to transfer their benefits to another pension arrangement
- Verification of date of birth and marriage/civil partnership either by the provision of birth and marriage/civil partnership certificates of the member and spouse/civil partner (if not already produced) or by electronic means, such as checks with credit agencies.

3.3 SCHEME ADMINISTRATOR DUTIES AT RETIREMENT

A Relevant Benefit Crystallisation Event (RBCE) occurs when a member becomes entitled to a relevant lump sum. This means that the relevant lump sum that is being paid must be tested against the member's available:

- Lump Sum Allowance (LSA), and
- Lump Sum and Death Benefit Allowance (LSADBA).

To enable the scheme administrator to do this, the member must confirm whether they have previously crystallised any benefits with other registered pension schemes, and whether they will also be taking any benefits from another registered pension scheme either before or on the same day as they take their benefits from the scheme.

If the member is entitled to an enhancement, or has enhanced, individual or fixed protection status, they must provide the scheme administrator with evidence of this entitlement before the benefits are set up.

The administrator must assess whether the relevant lump sum coming into payment will take the member over their available LSA and/or LSADBA and whether tax must be applied to the relevant lump sum that is coming into payment.

The member must be provided with a statement showing the amount of LSA and LSADBA that has been used when a relevant lump sum has been paid. This information must be given to the member within three months of the date the BCE occurs. This information must also be provided each tax year. This could be on the member's P60 or annual pension increase letter, for example.

3.4 RETIREMENT OPTIONS

3.4.1 Scheme Pension

A scheme pension is typically provided by a DB arrangement although they can be paid in respect of DC arrangements.

Scheme pensions must:

- Be payable for the life of the member
- Be paid at least annually
- Not be capable of being reduced year on year (except in limited circumstances)
- Paid directly by the Scheme Administrator, or by an insurer chosen by the Scheme Administrator

Where a scheme pension is paid in respect of a DC arrangement, the member must have been given the opportunity to select an alternative annuity provider. This is known as the Open Market Option.

3.4.2 Lifetime Annuity

The typical method of providing a retirement income from a DC arrangement is via the purchase of an annuity with an insurance company.

An annuity is an insurance product by which the insurer guarantees to pay a regular income for the rest of the member's life in exchange for the value of the member's accumulated retirement pot.

Once set up, the basis of the annuity is fixed, so it offers a secure lifetime income, regardless of stock market performance. It does however mean that the member is tied to the terms of the annuity when it is purchased even if the market conditions are not favourable at the time. Income from an annuity is taxable in the same way as most other sources of income (i.e. through PAYE) and depends on the member's individual tax liability.

The value of a member's pension fund at retirement depends on such things as the amount of contributions paid into it, the investment returns on that money and the investment manager charges deducted. Similarly, the amount of benefits that a member's pension fund will be able to buy at retirement depends on several things, including the cost of buying a pension and what benefit options they choose on retirement. A member's age at retirement also affects the amount of pension they can buy, because the younger a member is the longer the pension is expected to be paid for, and the higher the cost of buying the annuity. Pension projections, known as Statutory Money Purchase Illustrations (SMPIs), which are provided as part of the member's annual benefit statement should give members an idea of the level of income they could expect.

The cost of buying an annuity is closely linked to interest rates and how long people are expected to live. As future interest rates are uncertain, no guarantee can be given as to the size of the pension a member will be able to buy with their fund in the future.

3.4.3 Open Market Option

Annuities are provided by many different insurance companies. They offer different annuity rates and these change frequently. This means that at any particular time, some firms will be more competitive than others. An Open Market Option gives members the right to 'shop around' for annuities from external providers to compare what is on offer.

By offering an Open Market Option, the trustees/managers can be assured that the member has the ability to obtain the best annuity available at the time of retirement. There is no need for the trustees/ managers to check current rates with each provider individually; there are a number of firms which offer these services on a chargeable basis.

Members are strongly recommended to take independent financial advice when looking at the Open Market Option.

3.5 ANNUITY OPTIONS

The scheme rules may determine the type of annuity the member may buy. For example, legislation used to require that annuities purchased with contributions made after 6 April 1997 had to increase in line with Limited Price Indexation (LPI). Although this requirement has now been removed from legislation, the old requirement may still be incorporated in the scheme rules.

Leaving aside the constraints that may exist by either scheme rules or legislation, there are currently a number of options available which can offer greater flexibility over future income. For example:

- Taking a pension commencement lump sum and having a reduced annuity
- An annuity that provides for a spouse or dependant's pension on the member's death
- A flat rate annuity or one that increases in payment to counter the effects of inflation.
- An annuity with an attached guarantee period. This guarantee period runs from the date of retirement. It means that, should the member die within this guarantee period, the remaining pension payments that would have been made until the end of the period are paid to his/her spouse or dependants.

3.5.1 Enhanced Annuities (Impaired Life Annuities)

Annuity providers will pay a higher income if the member has certain medical conditions. For example, the annuity provider may be able to offer a better income (on the same fund value) if the member:

- Smokes, and has done so for a significant amount of time
- Takes regular medication
- Suffers from chronic asthma
- Has high blood pressure
- Has recently undergone major surgery
- Suffers from diabetes
- Has ever suffered a serious illness such as cancer, stroke, or multiple sclerosis

This is because, if they fell into any of the categories above, the length of time the annuity provider would expect a member to live would be less than that of a healthier member.

3.5.2 Annuity Documentation

It should be noted that annuity rates offered are generally guaranteed for only a limited period. Therefore, it is important that as soon as the member has completed the necessary paperwork, the fund is disinvested and paid across to the provider promptly.

There is normally a considerable amount of paperwork required to set up an annuity. The member will usually be required to provide:

- An application form
- Medical questionnaire
- Original birth certificate
- If a spouse or dependant's pension is also being provided, then the spouse/dependant's birth certificate will also be required, together with a marriage certificate if appropriate
- If the annuity is being set up in the trustees' name, the trustees will also be required to complete the application form

3.6 ALTERNATIVES TO BUYING AN ANNUITY

Recently, more members have begun to explore alternative options to the traditional route of annuity purchase. This may be because they do not need the security and regular payments provided by an annuity and would rather leave their pension fund invested, or the current annuity rates don't provide value for money. While this provides more flexibility it does carry more risk.

Annuities have become more expensive. This is largely as a result of increased life expectancy and lower investment returns on low-risk assets which are used by insurers to back the annuity policy. Now that people are living longer, annuity purchase may involve locking in pension funds into a product that is fixed earlier on in an individual's life. It is very difficult for members to be able to determine the right annuity type and right death benefits given that their lifestyle may change significantly in later years. Also, annuities

are fixed meaning it is not possible for income to fluctuate (outside of indexation within the terms of the annuity contract), which can cause issues with tax planning in later years. Due to this, a number of alternatives to annuity purchase have grown in popularity.

The amount of choice available to members with DC arrangements has increased even more since 6 April 2015, following the introduction of new pension flexibilities.

The alternatives to buying an annuity are:

- Income withdrawal
- Short term annuities
- Uncrystallised Funds Pension Lump Sums (UFPLS)

3.6.1 Income Withdrawal

The term 'Drawdown Pension' replaced the previously used terms 'Unsecured Pensions' and 'Alternatively Secured Pensions' from 6 April 2011 as part of the changes introduced by the Finance Act 2011. Drawdown Pension can be started from age 55 onwards, unless the member has a protected pension age or is retiring earlier due to ill health in which case a pension may be drawn earlier.

Rather than use their DC pot to buy an annuity and individual may prefer to leave their pot invested and draw an income directly from it. This is known as income withdrawal.

At retirement a member can take up to 25% of their pot, tax-free, as a pension commencement lump sum and designate the remainder to provide flexi-access drawdown. The member can then take as little or as much of their flexi-access drawdown pot as they like. These drawdown payments are treated as income and will be subject to Income Tax at the member's normal marginal rate.

Prior to 6 April 2015, income drawdown could be taken as either flexible drawdown or capped drawdown (and before that as either unsecured pension or alternatively secured pension).

Unsecured pensions were only available to members under the age of 75 where instead of buying an annuity the member could call on their invested funds subject to an annual maximum limit. Alternatively Secured Pensions worked in a similar way except they were available to members from age 75.

Capped drawdown, like unsecured pensions, provided an individual with a means of taking variable pension benefits without setting up an annuity, subject to a maximum annual withdrawal limit. The maximum pension income that could be paid from a drawdown fund under capped drawdown was equal to 150% of the annual amount of a level, single-life, lifetime annuity, without a guarantee period, which could be bought for the member on the date of calculation. For drawdown years prior to 27 March 2014, withdrawal was restricted to 120% of the annual annuity amount. The maximum limit is reviewed at set intervals dependent on the age of the member. For example, capped drawdown was available to members over age 75 but the maximum withdrawal limit must be reviewed annually. Anybody who was receiving income under a capped drawdown arrangement on 6 April 2015 could choose whether to continue to receive their income under this arrangement or convert it to a new flexi-access drawdown arrangement.

Flexible drawdown was only available to members who are no longer active members of any pension scheme and who met a 'minimum income requirement' of £12,000 per annum. This included other scheme pensions or lifetime annuities in payment and state pension benefits. Providing they met the qualifying conditions, flexible drawdown enabled individuals to have full access to their drawdown fund without limit. The amount withdrawn was taxable as pension income. Prior to 27 March 2014, the minimum income requirement was £20,000 for flexible drawdown. Any flexible drawdown arrangements in place on 6 April 2015 were automatically converted to a new flexi-access drawdown arrangement.

3.6.2 Short Term Annuities

Short term annuities are annuities which pay a set income for a period of up to five years. They may be an attractive option for members wishing to ease themselves into retirement by a move to part time working. They may be used in conjunction with drawdown.

3.6.3 Uncrystallised Funds Pension Lump Sums (UFPLS)

Uncrystallised Funds Pension Lump Sums were introduced on 6 April 2015 and give members with DC benefits the opportunity to take their benefits either in one go, or in smaller chunks.

An UFPLS can be taken from any uncrystallised funds (funds that have not already been used to provide retirement benefits).

The first 25% of an UFPLS is paid tax free, and the remainder is subject to Income Tax at the member's marginal rate.

A member should carefully consider their tax position when deciding whether to take a UFPLS as taking a large lump sum in one go may move them into a higher tax bracket, whereas taking smaller lump sums over a number of years can reduce their tax bill.

Although trust-based schemes may allow members to take an UFPLS as single lump sum (often to facilitate payment of a trivial commutation lump sum), many trust-based schemes do not offer the option of taking UFPLS as a series of lump sums due to the administrative complexities involved. If a scheme does not offer such a facility and a member wishes to use this method to provide income for a number of years, the member will need to transfer their funds out of the existing scheme to a specialist provider.

3.7 PENSION COMMENCEMENT LUMP SUM (PCLS)

A PCLS of 25% of the value of the total benefits being taken from the scheme may be paid, providing the scheme rules allow.

For a DC arrangement this will typically be 25% of the value of the member retirement pot. It is a little bit more complicated for DB arrangements due to the way that such pensions are valued.

Where the member's lump sum entitlement was greater than 25% as at 5 April 2006, this larger sum may be protected under the scheme rules. The scheme administrator is responsible for checking whether this protection applies.

Members who had a lump sum entitlement greater than £375,000 at 6 April 2006 may have applied for protection under transitional arrangements. Also, a member with Fixed Protection 2012, 2014 or 2016 could have a higher lump sum entitlement as the Allowances limit for these members is the higher of:

- £1.8m (2012), £1.5m (2014), £1.25m (2016), or
- the Lump Sum Allowance of £268,275 and the Lump Sum and Death Benefit Allowance limit of £1.0731m.

The administrator should therefore check carefully any protections the member may have, when calculating their retirement benefits.

A PCLS is paid tax-free and can only be paid in conjunction with a pension entitlement, be that a Scheme Pension, Lifetime Annuity or Drawdown. It can be paid up to six months prior to and twelve months after the entitlement to the connected pension arises; payment outside of this window will be an unauthorised payment.

3.8 TRIVIAL COMMUTATION LUMP SUMS

Where a member's total pension benefits are small, it may be possible to commute the whole of a members benefit into a one-off lump sum. This is known as trivial commutation. Prior to 6 April 2015, the Trivial Commutation Lump Sum payment could be paid in respect of all of a member's benefits in the scheme, both DB and DC. From 6 April 2015, as an Uncrystallised Fund Pension Lump Sum has been introduced (which allows members to fully commute an unlimited amount from their DC pot), the Trivial Commutation Lump Sum payment is now paid in respect of DB pension rights or scheme pensions in payment derived from DC pots.

The standard rule for trivial commutation is that it is only available where the value of the individual's pension rights from all registered schemes (including DB, DC, cash balance and pensions in payment before the date the benefits are commuted) does not exceed £30,000, but there are some exceptions noted below. The 2014 Budget increased this figure from £18,000 for commutation periods starting on or 27 March 2014.

There are a number of conditions that must be met in order to pay a Trivial Commutation Lump Sum. A member may commute one or more of his/her pension arrangements at any time from the age of 55 (before 6 April 2015 the minimum age was 60 and prior to 6 April 2011 an upper age limit of 75 applied), provided that:

- All the DB benefits from the chosen scheme or schemes are commuted
- The member must have some available allowance
- If more than one arrangement is to be commuted, all commutations must take place within a twelve-month period
- The value of all the member's pension rights cannot exceed £30,000 on the nominated date, which may be any date within three months of the start of the commutation period. The valuation methodology is set out in legislation. The actual amount paid to the member is determined by the scheme and may be more or less than this.
- The member can choose the nominated date, but if no date is chosen, a default nominated date is chosen by the trustees and is taken as the first day of the commutation period
- A Trivial Commutation Lump Sum must extinguish a member's entitlement to defined benefits under the scheme. Payment of any DC benefits is paid as an Uncrystallised Fund Pension Lump Sum. Any benefit commuted outside these circumstances will be treated as an unauthorised payment and suffer the associated tax charges

GMPs (subject to further conditions) and Section 9(2B) rights may all be commuted on the grounds of triviality and are included within the £30,000 triviality limit. For members over GMP age, then no further conditions are necessary. The same is true of GMP subject to fixed rate revaluation. The GMP must be revalued up to GMP Age when checking the commutation limit. Where GMP is subject to Limited Rate or Section 148 orders, the amount of GMP payable will not be known until the last revaluation has been added, Members below GMP Age may, therefore, have to wait until they reach GMP Age before they can commute their GMP.

Where benefits that are not in payment are trivially commuted, the first 25% of the payment will be tax free, with the balance taxed at the member's marginal rate. This 25% deduction is given to reflect that the member would generally have been entitled to a PCLS of 25% of the capital value of their benefit. If the member's benefits are in payment, the whole of the benefit is taxed. Trivial commutation payments have to be processed through a payroll system and taxed through the PAYE system.

From 1 December 2009, regulations came into force which widened the circumstances where trivial lump sums could be paid. These regulations allow small lump sums of less than £10,000 to be paid, irrespective of the value of benefits elsewhere, provided that the remaining conditions for payment are met. This figure increased from £2,000 for payments from 27 March 2014 and was also introduced by the 2014 Budget.

A small lump sum extinguishes all of a member's benefits in the scheme (both DC and DB benefits). However, the scheme rules must allow this type of authorised payment to be paid.

3.9 EARLY RETIREMENT

Schemes will usually allow members to take their pension benefits before their normal pension age and the options available are normally similar to those described for retirement at NPA. There are however some additional considerations.

3.9.1 Voluntary or redundancy

Unless they are suffering from ill health a member cannot normally take their pension benefits before age 55 (known as the normal minimum pension age). Certain individuals may be able to take their benefits from age 50 if, on 6 April 2006, they have an unqualified right to take their benefits at that age (unqualified means that there are no conditions to be met in order for the benefits to come into payment, such as requiring employer or trustee consent) and that right existed in the schemes rules on 10 December 2003.

Early retirement is usually subject to the consent of the scheme trustees and possibly also the employer. When benefits are paid early, generally the resulting pension benefits will be lower. This is to reflect the fact that the benefits are likely to paid for a longer period.

For a DB arrangement, the benefits are normally calculated in the same way as for retirement at NPA using pensionable service and salary up to the date of retirement (or earlier date of leaving service) but are then reduced (or 'discounted') for early retirement. Occasionally, e.g. on redundancy, early retirement pensions may be augmented (enhanced) by the employer with the consent of the trustees and subject to any funding costs being calculated and paid as necessary.

Where benefits are taken early from DC arrangements, the lower pension is usually as a result of the fact that the retirement pot will be lower (as fewer contributions will have been paid in and the pot will not have had as long to grow with investment returns) and because the cost of buying an annuity is generally more expensive the younger a member is.

For early retirement on a voluntary or redundancy basis, the duties described for normal retirement apply.

3.9.2 Ill Health

If an employee is suffering ill health before NPA, he/she may be eligible for an ill health early retirement pension from the scheme. The scheme rules will define the conditions that must be met for this benefit to be provided and it may be subject to the trustees' consent.

Ill health pensions are often augmented either as of right in accordance with the scheme rules, or at the discretion of the trustees and/or the employer.

For retirements due to ill health the requirements are that the scheme administrator has received evidence from a qualified medical practitioner (usually in the form of a written report) to the effect that the member is, and will continue to be, medically incapable (either physically or mentally) as a result of:

- Injury
- Sickness
- Disease, or
- Disability

of continuing his or her current occupation and that the member has actually ceased to carry on their occupation.

The scheme rules may allow the pension to be reduced or suspended if the member makes a partial recovery or returns to full health. Where this is the case, the member should be advised of this possibility at the point of retirement.

It may be possible for member in 'serious ill health' to commute the whole of his/her pension at any age provided the pension is not already in payment. Whether a member is in 'serious ill health' is interpreted strictly and narrowly. The Scheme Administrator must have received evidence from a registered medical practitioner that the member's life expectancy is less than one year. In addition, the payment must extinguish all of (and only) the member's entitlement to benefits under the arrangement, so any survivors' benefits must be moved to a separate arrangement before the lump sum is paid.

Serious ill health lump sums are tax-free if paid before age 75, provided the payment does not take the member over their available LSADBA. Any amount in excess of the individual's available LSADBA is subject to tax.

For serious ill health lump sums paid after the member has reached age 75; if the payment is made on or after 16 September 2016 it is subject to Income Tax at the member's marginal rate.

It is important that, in determining whether a member qualifies for ill or serious ill health retirement, the provisions of the scheme rules are followed carefully, and all legislative requirements are met to avoid a decision being challenged.

Once it has been established that the relevant conditions for the particular type of ill health have been met, the administrator duties are as outlined above for the other retirement types.

3.9.3 If the Scheme is Contracted Out

GMPs are not payable before GMP payment age. Therefore, a check must be made to ensure that the expected pre 6 April 1997 pension that will be in payment at GMP payment age will be at least equal to the GMP at that age.

For post 5 April 1997 contracted out pension the same requirements apply as for normal or late retirements described above.

3.10 LATE RETIREMENT

As well as giving members the option to take their benefits early, scheme rules may also allow members to defer taking their benefits after NPA. This may be because they are still working and don't need the income at that time.

Again, trustee and/or employer consent may be required for a member to defer taking their pension.

When the pension comes into payment, it is likely to be higher than it would have been had it been paid from NPA. If a member remains in employment after NPA, they may be allowed to continue to accrue additional pensionable service in a DB arrangement or continue to contribute to a DC arrangement. Even where additional accrual after NPA is not allowed, the pension that would have been payable at NPA is likely to be enhanced to reflect that fact that it will be paid for a shorter period of time.

Summary

This Chapter has detailed the various retirement options available and the implications for each of them.

Self Test Questions

- Distinguish between a scheme pension and a lifetime annuity.
- List the options that may be available to a member when they reach NPA.
- What is an uncrystallised funds pension lump sum (UFPLS) and what are the tax issues a member needs to consider if they decide to receive an UFPLS?
- What are the conditions that must be met before a trivial commutation lump sum can be paid?

CHAPTER 4

DEATHS

INTRODUCTION

This Chapter sets out the types of benefits that might be payable on the death of a scheme member and how to comply with the necessary legislative requirements. Note that reference to spouse in this Chapter includes spouses under same sex marriage.

4.1 TYPES OF BENEFITS

4.1.1 Death in Service before NPA

Typically, the benefits payable would be:

- A lump sum death benefit calculated as a multiple of the member's salary at date of death.
- A dependants' pensions payable to a spouse/civil partner and also to children who meet any conditions specified in the scheme rules and in legislation. In the case of a DC arrangement, the value of the member's retirement pot may be paid as a lump sum instead of providing a dependants' pension.

The lump sum will usually be payable under a discretionary trust. This is covered later in this chapter under 'Exercise of Trustees' Discretion'.

A refund of the member's contributions may also be payable under a discretionary trust or may be payable automatically to the legal personal representatives. Where legal personal representatives are involved, the Grant of Probate or Grant of Letters of Administration should be obtained before payment is made.

4.1.2 Death in Service after NPA

In these circumstances the member would normally be treated the same as for death in service before NPA but this will depend on the scheme's rules. Usually therefore the benefits payable would be as described above.

4.1.3 Death in Early Retirement before NPA

Typically, the benefits payable from DB arrangement would be:

- Dependants' pensions payable to a spouse/civil partner and also possibly to qualifying children
- A lump sum representing the balance of the pension that would have been paid to the member during a 'guarantee period' (usually five years from the retirement date)

The death benefits payable in respect of a DC arrangement will depend on the options selected by the member, for example; the death benefits included as part of the purchase of an annuity, or if the member has selected to take benefits via the drawdown route.

4.1.4 Death in Retirement after NPA

Typically, the benefits payable would be:

- A dependants' pensions payable to a spouse/civil partner and also possibly to qualifying children
- A lump sum representing the balance of the pension that would have been paid to the member during a 'guarantee period' (usually five years from the retirement date)

The death benefits payable in respect of a DC arrangement will depend on the options selected by the member, for example; the death benefits included as part of the purchase of an annuity, or if the member has selected to take benefits via the drawdown route.

4.1.5 Members who Die following Flexible Retirement

Flexible retirement is where a member has drawn some, or all, of their accrued pension benefits but remain employed with the sponsoring employer. They may also continue to accrue additional pension benefits.

In these circumstances the benefits payable will depend on what the scheme rules provide for but may include both a death in service lump sum and a death after retirement lump sum. In addition, spouse's/civil partner's and children's pensions may also be payable.

4.1.6 Deferred Pensioners

Typically, the benefits payable would be:

- Dependants' pensions payable to a spouse/civil partner and possibly to qualifying children and/or
- A refund of the member's own contributions

4.2 LUMP SUM DEATH BENEFITS

The two main types of lump sum death benefit (known as relevant lump sum death benefits) that need to be distinguished are:

- A defined benefits lump sum death benefit, which is a lump sum paid from a DB arrangement on the death of a member. This includes lump sum death benefits based on multiples of earnings, service, or another factor. An example might be a lump sum that represents the balance of a guarantee on the death of a pensioner. The majority of the lump sum death benefits described will be defined benefits lump sum death benefits.
- An uncrystallised funds lump sum death benefit, which is a lump sum death benefit paid from a DC arrangement on the death of an active or deferred member.

Any lump sum death benefit paid will normally be deemed a 'relevant lump sum death benefit', unless the member has designated that they want the benefit paid as a taxable lump sum (known as a pension protection lump sum death benefit if paid from a DB arrangement). In addition, if the value of a dependant's pension is no more than £30,000, it is possible for it to be commuted entirely as a lump sum (known as a trivial commutation lump sum death benefit), provided the scheme rules allow this.

Before any death benefits are paid, the administrator (and insurer where applicable) will need sight of the original death certificate. If there is a spouse/civil partner and/or children to whom pensions are payable, their birth certificates (and marriage/civil partner registration certificate) and bank details will also be required.

In some schemes, discretion exists to pay a spouse's pension to a financially dependent partner. In these cases, evidence needs to be gathered and the case referred to the trustees for a decision.

4.2.1 Payment of Lump Sum Death Benefits

As for other benefits, the payment of lump sum death benefits is governed by the scheme rules. In addition, however, under many schemes the trustees will have discretion as to who should receive the lump sum death benefit.

The payment of any lump sum death benefits must be paid via the scheme payroll and reported to HMRC under the RTI reporting framework. This applies even where there is no tax liability due in respect of the payment.

4.2.2 Exercise of Trustees' Discretion

Lump sum death benefits are often paid to a recipient selected at the discretion of the trustees, although scheme rules may restrict the categories of potential recipients the trustees can consider. The usual practice is as follows:

- The member will have been asked to nominate one or more beneficiaries by completing a nomination or expression of wish form, although the trustees are not obliged to comply with this nomination
- The trustees will determine the potential recipient(s) taking account of both the member's nomination form and also the member's personal circumstances at death
- The trustees usually make their decision as to which of the potential recipient(s) will receive a lump sum death benefit, and in what shares, either at a full trustee meeting or through an appointed committee

The benefit of paying lump sum death benefits under the trustees' discretionary powers is that it does not form part of the deceased's estate and therefore is not assessable for Inheritance Tax.

It is possible for an earmarking order under a divorce settlement to require that a specified percentage of any lump sum death benefit is to be paid automatically to the member's ex-spouse/ civil partner. Allowance would need to be made for this before the trustees exercise their discretion over any remaining lump sum death benefit.

4.3 IF THE SCHEME WAS CONTRACTED OUT

Where a member dies with an entitlement to contracted out benefits, subject to certain qualification requirements:

- Widows are entitled to 50% of the whole GMP in respect of all contracted out service prior to 6 April 1997, and a pension of 50% of the member's pension (before commutation) for service after 5 April 1997 to meet the reference scheme test conditions
- Widowers (including widowers from same sex marriages)/civil partners/widows of female members under same sex marriages are entitled to 50% of the post '88 GMP only, and a pension of 50% of the member's pension (before commutation) for service after 5 April 1997 to meet the reference scheme test conditions

Where GMPs have been converted to ordinary scheme benefits, survivors' benefits must be provided from the converted benefits in the same circumstances and for the same service periods that would have applied had the GMP not been converted.

4.4 CHECKS REQUIRED BY HMRC

Payment of a relevant lump sum death benefit where thee member dies before age 75 is a RBCE and therefore the lump sum death benefit amount must be tested against the member's available Lump Sum and Death Benefit Allowance (LSADBA). It is tax-free unless the member's available LSADBA is exceeded, in which case a tax charge applies to the excess amount. Any tax charge is payable by the recipient of the lump sum, so the scheme administrator always pays any relevant lump sum death benefit gross.

The Scheme Administrator must inform the member's legal personal representatives of the amount and date of the payment of any relevant lump sum death benefit together with the amount of LSADBA used up by the payment. This must be done within three months of the final lump sum being paid.

The legal personal representatives are responsible for testing the lump sum death benefit against the member's available LSADBA and reporting any excess amount to HMRC who will notify the recipient(s) of the lump sum of the tax charge they must pay.

Relevant lump sum death benefits paid on the death of a member before age 75 must be paid within two years of the earlier of:

- The day on which the Scheme Administrator first knew of the member's death, or
- The day on which the Scheme Administrator could have first reasonably known about the member's death It will still be an authorised payment if paid after the two-year period but there will be a tax charge.

4.4.1 Lump Sum Death Benefits Subject to Tax

A relevant lump sum death benefit can also be paid on the death of a member after age 75. This payment will be subject to tax, as described below.

As an alternative to a relevant lump sum death benefit, schemes may allow members to opt for any lump sum death benefit payable on their death after retirement to be treated as a pension protection lump sum death benefit. These lump sums may be beneficial for members who had already exceeded their limits during the former LTA regime as the pension scheme would deduct the tax when the lump sum is paid rather than the deceased member's personal representatives.

The amount of tax payable, where a lump sum death benefit is subject to tax, depends on status of the recipient.

If the recipient is receiving the payment in their own right, then the payment is treated as pension income and will be taxed under PAYE via the RTI process.

If the recipient is receiving the payment in their capacity as a representative of another person or organisation, such as a trustee, a personal representative or a director/partner in a firm, then the payment will be subject to a special lump sum death benefit charge. This is a flat rate charge of 45% (55% for lump sums paid before 6 April 2015) which will be deducted by the scheme administrator and accounted for via the quarterly Accounting for Tax return.

4.4.2 Pension in Payment – Other Considerations

For members who die after retirement, generally, any pension payments paid in respect of any period after death must be recovered otherwise the overpaid pension will become an unauthorised payment, unless the payments represent a continuing guarantee on the member's pension. This can be done by recalling the payment from BACS or requesting repayment from the estate. There are two exceptions to this requirement which apply where the Scheme Administrator was not aware of the member's death:

- The total overpaid does not exceed £250 net
- The overpaid instalment(s) were paid within six months of the member's death

If the member retired after 5 April 2006 and died after age 75, any dependant's pension payable must not exceed a prescribed limit. Any amount in excess of this limit would be an unauthorised payment.

This limit was initially set, for the 2016/17 tax year, at £25,000 (or the level of the member's pension at the date of death, if higher). This limit will then be increased each year by the higher of; 5%, CPI or RPI. Prior to this date the limit was the amount of member's pension paid in the previous twelve months, plus 5% of any PCLS paid on retirement. For the 2024/25 tax year, the limit has increased to £41,600.

Dependants' and spouses'/civil partners' pensions do not count towards the recipient's own LSADBA.

4.5 SPECIAL CONSIDERATIONS

4.5.1 Payment of Spouses'/Civil Partners' and Children's Pensions

- Spouses'/civil partners'/dependants' pensions are taxable under the PAYE system. Children's pensions should always be set up in the name of the child, even if they are being paid into the spouse's bank account, to ensure that the spouse is not taxed on the child's income.
- Scheme rules may specify a maximum age at which the payment of children's pensions ceases. It could be a fixed age e.g. 16 or 18 or depend on whether the child is still in full time education. Legislation requires children's pensions to cease at 23, except in special circumstances.
- Scheme rules may specify a reduction to the spouse's pension if the difference in the age between the deceased member and the spouse is more than a defined number of years
- Scheme rules may include a definition of 'dependant' where the partners are not in a marriage, same sex marriage or registered civil partnership. Even if the rules do not, legislation imposes conditions on who can be treated as a dependant of a member and so be entitled to a dependant's pension.
- Registered civil partners and widows of female members under a same sex marriage must, as a minimum, receive the same benefits as widowers in respect of contracted out benefits and the member's pensionable service from 5 December 2005. For benefits accrued before this date (except contracted out benefits) the scheme rules will dictate whether registered civil partners and same sex spouses are entitled to the same benefits as a spouse. Students should note that, in July 2017, the Supreme Court issued a ruling in the case of Walker v Innospec stating that the exemption in the Equality Act 2010 which allowed schemes to restrict entitlement to survivors' pensions to benefits earned from 5 December 2005 was inconsistent with the relevant EU directive. The implication of this ruling is that schemes must provide equal survivors benefits to civil partners and same sex spouses in respect of all pensionable service, that is, as per survivors of the opposite sex to the member.

4.5.2 Evidence of Continued Existence

To avoid making unauthorised payments and to prevent possible fraud, pension schemes should require members or dependants receiving a pension to prove continued existence and certificates to this effect should be requested at regular intervals, preferably certified by a professional person such as a doctor or solicitor.

Pension records can also be checked on a monthly or other basis against various databases such as the Bereavement Register as an additional measure to ensure that pensions do not continue to be paid where members have died.

4.5.3 Payments to the Estate

Even where the trustees have the power to decide who receives a lump sum death benefit under the trustees' discretionary powers, there are cases where the benefits have to be paid to the estate, for example where the trustees cannot identify a suitable recipient. Where payments are made to the estate of a deceased member under the trustees' discretionary powers, the payment is still excluded from the value of the estate for Inheritance Tax purposes.

In some cases, a return of a member's contributions is automatically made to the personal representatives of the deceased member, on the basis that these are the member's own monies and should form part of the estate. Where the scheme rules require a payment to be made to the estate, that payment forms part of the estate for Inheritance Tax purposes.

Summary

This Chapter has covered the various options for death benefits and the associated requirements.

Self Test Questions

- Outline the process trustees normally follow before they exercise their discretion.
- Describe the two main types of lump sum death benefits.
- Describe the checks that are required by legislation.

CHAPTER 5

PENSIONS ON DIVORCE

INTRODUCTION

When determining the division of a couple's assets on divorce or on dissolution of a registered civil partnership, a Court must take the value of any pension benefits into account. If the Court decides to issue an order against any pension benefits, it can issue either a pension attachment order or a pension sharing order. Such orders can be made in respect of active, deferred or pensioner members.

In the following sections, any reference to divorce and an ex-spouse also includes a registered civil partnership and former registered civil partner respectively.

5.1 PENSION ATTACHMENT ORDERS (EARMARKING ORDERS)

Introduced under the Pensions Act 1995, a pension attachment order (generally referred to as an 'earmarking order'), requires part or all of the member's benefits to be paid to the ex-spouse when the member retires or dies.

In England and Wales, earmarking orders may be made against pension payments as well as lump sums paid on retirement and on death. In Scotland, only lump sum benefits can be earmarked.

If an earmarking order is served against a member's benefits, it is vital that this is noted on the member's record so that the order is taken into account when the member's benefits are put into payment.

5.2 PENSION SHARING

Pension sharing on divorce was introduced by the Welfare Reform and Pensions Act 1999. For divorce proceedings commencing on or after 1 December 2000, some or all of a member's pension can be shared with an ex-spouse. 'Earmarking' can still be applied instead, however pension sharing is now a far more common approach.

Unlike 'earmarking', pension sharing requires the actual transfer of benefits from the member to the ex-spouse. This results in a reduced pension benefit for the member, and the ex-spouse being entitled to a pension benefit in their own right. The reduction in the member's pension is known as a pension debit and the new pension rights for the ex-spouse is known as a pension credit.

The scheme policy on divorce will determine whether the ex-spouse or civil partner will be entitled to use their pension credit to secure a deferred pension in the scheme, or whether they must transfer this benefit to another suitable arrangement.

Trustees of a scheme are entitled to recover any additional costs they incur in the implementation and administration of a pension sharing order. The scheme will normally issue a schedule of charges to the affected parties prior to receiving the final order. The pension sharing order will normally specify whether the member and/or the ex-spouse will meet the charges. The charges can either be paid direct to the scheme or the benefits of the member/ex-spouse can be reduced to meet the charge. The trustees can determine which of these methods is available to the member/ex-spouse, and whether these charges must be met before the order can be implemented. They must set out their charges to the divorcing couple before the order is made, otherwise they will not be able to recover them.

5.3 ADMINISTRATION REQUIREMENTS

There are strict timeframes for providing information and implementing/administering any orders issued by the Courts. TPR may fine trustees or managers of pension schemes for failing to comply with these timescales.

Trustees must implement the pension sharing order by either:

- Providing the ex-spouse with benefits within their scheme
- Transferring the ex-spouse's pension credit to another suitable arrangement

An ex-spouse has the right to request that the pension credit is transferred to an external arrangement and, if such a request is made, the trustees must comply with it.

Where benefits are created for the ex-spouse within the scheme, administrators must create a new membership category to accommodate them: the pension credit member. To comply with the Data Protection Act 2018, the trustees must advise the pension credit member of the purposes their personal data will be used for.

Alternatively, in the absence of any request from the ex-spouse, the trustees can transfer the pension credit to another arrangement selected by them.

Summary

This Chapter has covered the different options for pensions on divorce.

Self Test Questions

- What is earmarking?
- How does pension sharing work?

CHAPTER 6

DELIVERING PENSION BENEFITS

INTRODUCTION

Trustees rely on external advisers to provide a variety of services, some of which are required by legislation. By considering the advisers that trustees may appoint, you will appreciate the range of duties and responsibilities that trustees face when running a pension scheme.

6.1 ADVISERS AND DELEGATES

The Pensions Act 1995 requires the trustees to appoint certain professional advisers. For a DB scheme this will generally be at least an auditor, and a scheme actuary. However, there are exceptions for:

- Unfunded arrangements
- Non registered arrangements
- Schemes with only one member
- Schemes with fewer than 12 members, provided they meet specified conditions
- Schemes providing only lump sum death benefits
- Certain public sector arrangements

The trustees are also likely to require a legal adviser and an investment consultant. If the trustees are to rely on professional advice, they must formally appoint the individual or organisation in accordance with the requirements of the Pensions Act 1995.

The appointment of professional advisers must be in writing and should clearly specify the role and responsibility of the adviser, as well as other details such as:

- The date the appointment takes effect
- To whom the adviser will report
- From whom the adviser is to take instructions

The trustees usually delegate certain tasks such as the administration of member records and benefits, and fund management to specialist third parties or the employer. Despite this, the trustees are ultimately accountable, so written agreements including service levels with terms and conditions are essential.

If the scheme is run as a wholly insured pension scheme, the insurance company will generally provide comprehensive services, although the trustees may still use an external pensions adviser. Investment, documentation and actuarial services are usually indirectly included as part of an insured contract.

For a fully or partly self-administered scheme, the trustees may appoint firms of pension consultants, brokers, actuaries, lawyers etc. to provide individual or comprehensive services, including employee communication, documentation, legal advice, liaison with government bodies and so on. Advisers can assist the employer and the trustees with member communications by producing booklets and announcements explaining scheme changes. Legal advisers can also provide a documentation service dealing with the scheme's governing documents such as the trust deed and rules.

The extent to which trustees make use of third party advisers to carry out services on their behalf will likely be guided by their regular risk management assessments. Trustees may secure more or fewer services with external providers based on their assessment of whether they have enough capacity or knowledge to carry out or manage the activities directly.

Where a self-administered scheme insures members' benefits but retains responsibility for paying the benefits it will usually retain its existing advisers, although some administrative functions such as payroll may be transferred to the insurer.

6.1.1 Actuaries

The trustees of a DB scheme must appoint a named 'scheme actuary' under the Pensions Act 1995. The scheme actuary must not be a trustee, administrator or member of the scheme. The actuary must acknowledge the appointment and confirm that they will notify the trustees of any conflict of interest.

On resignation or removal, a scheme actuary must produce a statement detailing any circumstances connected with the resignation which they believe may significantly affect the interests of scheme members or beneficiaries. The trustees have three months in which to replace a scheme actuary who has resigned, been removed or died.

Legislation sets out which functions must be carried out by the scheme actuary. Examples include

- Advice to the trustees on the funding of the scheme, including the valuation of the liabilities of the scheme and advice on the future contributions required to meet the statutory funding objectives
- Advice to the trustees on the method and assumptions to use to calculate cash equivalent transfer values
- Provision of actuarial certificates

The actuary would also provide advice on early and late retirement factors and cash commutation factors.

In addition, other actuarial services can be obtained by appointing a firm of consulting actuaries or by appointing a firm of pension consultants which employs its own actuaries.

6.1.2 Auditors

Regulations under the Pensions Act 1995 require a scheme's annual accounts to be audited. The primary function of the auditor is to:

- Compile a report stating whether or not the scheme accounts have been prepared in compliance with the regulations
- Prepare the auditor's statement on the contributions payable to the scheme
- Provide reasons for any negative or qualified statements in the auditor's reports
- Report material breaches of law of material significance to TPR

The auditor must meet the requirements of the Companies Act 2006 for a 'statutory auditor' or be specifically approved by the Secretary of State. An auditor of a scheme may not also hold a position as a trustee or administrator of that scheme, nor be a member of the scheme.

A formal letter of appointment must be signed by the trustees and the auditor. The auditor must acknowledge the appointment and confirm that they will notify the trustees of any conflict of interest.

On resignation or removal, an auditor must produce a statement detailing any circumstances connected with the resignation which they believe may significantly affect the interests of scheme members or beneficiaries. The trustees have three months in which to replace an auditor who has resigned, been removed or died.

6.1.3 Trustee Companies

An employer may appoint a trustee company instead of individually appointed trustees. Corporate trustees may operate as a professional trustee company or often as subsidiaries of pensions, legal or insurance companies. A corporate trustee may also be created specifically to act as the trustee of a particular scheme and may include member nominated directors or even professional trustee companies as its 'directors'.

6.1.4 Investment Services

Trustees generally delegate a range of investment related activities to external providers, including investment managers, investment advisers, custodians and investment monitoring services.

Investment Managers

Trustees usually delegate responsibility for day to day investment decisions for the scheme's assets to external investment managers. Provided such investment managers are properly appointed, trustees are not responsible for any poor investment decisions that may be made.

Investment manager appointments, which must be formally accepted, must be highly specific and will cover, among other things, the asset class(es) in which investments are permitted, the performance benchmark and agreed attribution (attribution is the allocation of excess return over the benchmark to certain activities) and risk tolerance (as a percentage of return or on some other basis).

Investment Advisers

While investment managers are responsible for the day to day investment of assets, investment advisers provide trustees with general guidance on asset allocation and benchmarks, taking into account the nature of the scheme's liabilities. Advisers also often report on the performance of investment managers, individually and overall. For schemes with 100 or more members, trustees must prepare and maintain a statement of investment principles, and they must obtain and consider the advice of an appropriately qualified and experienced investment adviser.

Many firms of pension consultants and advisers have specialist investment departments who will provide advice on investment allocation and strategy.

Custodians

A custodian is an organisation that is engaged to manage part of the scheme's assets, such as share certificates and property deeds, with the aim of reducing the risk of loss or fraud. They must either be formally appointed in writing using a custody agreement or they can be a party to the investment management agreement. Their appointment should be regularly reviewed to ensure that they do not expose the scheme to any significant risk.

Trustees generally appoint one or more custodians to hold securities and other assets on behalf of the scheme. If overseas investments are held, one or more sub-custodians will usually be appointed.

Trustees may also appoint additional third parties to work with a custodian to provide additional services such as the independent valuation of assets and managing cash and foreign exchange on a day to day basis.

Investment Monitoring Services

Trustees often participate in an investment performance monitoring service, provided by a merchant bank or other investment specialist. Specialists can also monitor the performance of insured contracts and managed funds operated by insurance companies, by comparing the investment portfolios of other funds and providing regular reports on investment performance.

6.1.5 Pension Consultants

Pension consultants can provide advice on legislation, scheme design, governance etc. as well as management services such as the organisation of trustee meetings and completion of the Scheme Return to TPR etc.

Services can also include the broking of insurance for risk benefits, e.g. death in service lump sums and dependants' pensions.

6.1.6 Administration

Insurance companies or other third party administrators can offer a range of services, including:

- Detailed recording of personal information, benefits and contributions
- Preparation of correspondence, having due regard to legislation
- Handling of new entrants, deaths, leavers, transfers and retirements
- Calculation and payment of benefits
- Maintenance of membership records
- Execution of contracted out procedures and making reports to HMRC
- Provision of banking and pension payroll services
- Production of the trustees' annual report and accounts

The use of third party administrators (often called 'outsourcing') is quite common in the pension industry, even for trustees of large schemes.

Service Standards

Some administration companies and departments have obtained accreditation such as ISO 9001 and Investors In People (IIP) quality standards. The intention behind this is the desire to refocus attention on the customer, to put in place service standards and to publish performance against these standards.

Accreditation can be seen as an advantage when trustees put out tenders for administration services, especially if they match the trustees' service level expectations.

Costs

All administration services have costs which are either implicit (e.g. a loading in the premium charged under an insured contract) or explicit (e.g. by fees charged by the various parties providing the services).

6.2 MODELS FOR DELIVERING PENSION SERVICES

There are a number of ways in which the trustees can carry out their obligations in running a pension scheme. The extent to which certain models are used can depend on the size of the scheme and the ability or appetite for the sponsoring employer to support certain services.

6.2.1 Bundled Services

These will typically be used by trustees of smaller pension schemes and are particularly common in 'insured' arrangements.

Under a bundled arrangement the trustees will look to a single provider who offers more than one service under the same contract. This will typically cover administration, actuarial and investment services. Larger schemes may also look to benefit from obtaining multiple services from a single provider to achieve benefits in scale.

6.2.1 In House or Outsource?

Some services may be provided directly by the trustees (usually via the sponsoring employer). These are known as in-house services. Services provided by a third party are known as outsourced services.

In house services

Services that are commonly provided in house are scheme secretarial and administration services. Some large schemes may also retain some in house investment support.

In house services are usually provided by the sponsoring employer on behalf of the trustee although those providing the service may be directly employed by the trustee. There should be an agreement between the employer and the trustee setting out the roles and responsibilities of the arrangement together with appropriate service standards.

The advantage of an in house arrangement is that there is generally a closer working relationship between the trustee and the people providing the service and member's may well feel more comfortable with their pension arrangements being looked after by other colleagues in the business. The disadvantages are that the scheme may be too small for the service to provide benefits in scale or it may be more difficult to maintain the appropriate level of knowledge about the scheme or maintain the service levels, particularly in times of higher than normal activity such as during a redundancy exercise.

Outsource services

Where it is not possible, or for strategic reasons the trustees choose not, to provide services in house, the trustees can appoint a third party to provide these services. This is known as outsourcing.

This could be provided as part of a bundled service or alternatively, separate agreements could be sourced for each service. For each outsourcing arrangement there will be a contract and agreement in place setting out exactly what services the outsourcer will provide and in what timescales. The trustees should monitor performance against the agreed service standards.

The nature of an outsourcing contract could take many forms. Looking at administration for example, the outsourcer may be required to provide a full service, including day to day contact with the scheme members. Alternatively, the members may look to the Company's HR function as their main point of contact regarding their pension and the outsourcer works in the background providing the necessary information to the HR department. This type of arrangement is known as a back office arrangement.

The outsourcer may also base some or all of their operations overseas. This is known as offshoring. Where an outsourcing contract involves any offshoring, it is essential that the trustees satisfy themselves that the relevant requirements of the Data Protection Act 2018 are complied with in relation to transferring member data overseas.

Summary

Trustees will generally have a range of external advisers to assist them in the running of the scheme. Some of these, such as the auditor and the scheme actuary, are required by law, whilst others are appointed for convenience.

All advisers and service providers should be appointed in writing, with their roles and responsibilities clearly specified.

Self Test Questions

- Distinguish between the role of an investment manager and an investment adviser.
- Suggest why a trustee or a member of a scheme must not be appointed as the auditor.
- When trustees are considering appointing a third party administrator, explain the issues that might influence their choice of administrator.

CHAPTER 7

COMMUNICATIONS AND RENEWALS

INTRODUCTION

Members should be given regular information about the benefits they are accruing. The disclosure regulations give members the right to request, once a year, a statement of their accrued benefits payable from normal pension age. In practice, however, the vast majority of DB schemes automatically provide this information to active members annually in the form of an annual benefit statement, despite there being no legal requirement to do so.

With DC schemes, the onus is very much on the member to make the important decisions; decisions which can greatly affect the level of benefits they then go on to receive. If members have a lack of understanding of their pension arrangements, they may well make poor decisions or take no action at all.

The points below are good practice guidelines for member communications.

7.1 THE IMPORTANCE OF EFFECTIVE MEMBER COMMUNICATIONS

If members do not understand their pension scheme, then they may not appreciate its value or realise how it can help them to save for their retirement. Trustees/managers and employers have a shared interest in seeing that:

- Members are engaged and motivated to plan for their eventual retirement.
- The scheme is effective in attracting, motivating and retaining employees.
- Time and resources are not taken up by ineffective communications exercises.
- Legislation is complied with.

7.1.1 What Makes Member Communications Effective?

TPR has stated its belief that effective communications should have the following qualities:

- Impact – to get the members' attention.
- Clarity – so the members are able to understand it.
- Accuracy – so members receive full and reliable information.

It is important that the right balance is struck between these qualities.

7.1.2 Good Practice When Communicating With Members

When looking to produce a communication aimed at pension scheme members, the trustees/managers and employers should take the following factors into account:

- Clear communication plan.
- Identify the best way to communicate.
- Tailor communications to the audience.
- Remember the needs of all different categories of members.
- Be open and honest.
- Avoid jargon.
- Choose the correct time to engage.

7.2 DISCLOSURE OF INFORMATION

The disclosure requirements were introduced to ensure that members are aware of their benefits, of the rights relating to those benefits and of changes that might affect their benefits directly or the scheme as a whole.

Disclosure regulations specify the minimum amount of information to be provided. In practice many schemes provide more than this, for example many DB schemes automatically send annual benefit statements to active members and a short form of the scheme annual report all members.

Originally there were two sets of disclosure regulations for occupational schemes and personal pensions. These have been repealed and replaced with a single set of regulations comprising the disclosure requirements for both occupational and personal pension schemes. This single set of regulations is known as the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 ('the 2013 regulations') which came into effect on 6 April 2014. Some schemes, for example those that provide only death benefits or have only one member, are exempt from the 2013 regulations.

With the introduction of the new pension flexibilities from 6 April 2015, the 2013 Disclosure Regulations were amended to ensure the new flexibilities operated as intended from 6 April 2015.

Disclosure regulations detail what information is to be provided, to whom and within what timescales. Some of the areas covered are:

- Basic scheme information
- The scheme's annual report
- Member benefit statements
- The annual Summary Funding Statement
- The Statement of Investment Principles (SIP), the Actuarial Valuation and the Schedule of Contributions (or Payment Schedule)
- Pensions flexibilities

The trustees' Statement of Investment Principles and accompanying Implementation Statement together with, in respect of defined contribution schemes, the Chair's statement, have to be published online on a publicly accessible web page.

7.3 DIFFERENT METHODS OF COMMUNICATING WITH MEMBERS

The disclosure regulations allow schemes to comply by providing information:

- Electronically by email
- Electronically by posting on a website
- Sending it by post

Certain conditions have to be met, for instance if a scheme wishes to use electronic communications, members must be notified in advance and must be able to choose to continue to receive information by post if that is what they prefer.

Trustees may delegate the task of sending out information to third parties (for example, scheme administrators), but they are responsible for ensuring the regulations are adhered to. TPR can impose fines on schemes if they fail to comply with the regulations.

7.4 DISCLOSURE REQUIREMENTS

The table below sets out some of the key disclosure requirements that schemes must satisfy so that they do not breach the disclosure regulations.

INFORMATION	REQUIREMENT
Provision of basic scheme information to a prospective member	Within one month of the scheme receiving their job holder information. If no such information has been received, within two months of them joining the scheme.
Provision of scheme's annual report	Within two months of the request being received.
Benefit statements for benefits other than DC	Within two months of the request being received.
Benefit statements for DC benefits	Must be given automatically within 12 months of the end of the scheme year.
Provision of summary funding statements	Within a reasonable period (normally three months) after the last date on which the scheme is legally required to obtain an actuarial valuation.
Provision of a flexible access statement	Within 31 days of the date the member flexibly accessed their benefits.
Provision of information on death of a member	Within two months of the scheme being notified of the death.
Winding-up of a scheme	The scheme must provide information to members and beneficiaries once winding-up begins and on discharging liabilities for particular individuals.

7.5 ANNUAL RENEWALS AND DISCLOSURE

This is also referred to as the annual renewal. Updating members' records with new salary information following salary reviews, changes to personal information, changes in hours worked etc. provides administrators with the details needed to calculate benefits and to provide insurers with the data required for insured benefit renewals (such as death in service benefits) and re-broking exercises to obtain the best insurance premium.

7.5.1 Active Members

An annual update of records usually takes place at the end of the 'scheme year'. The employer must ensure that all relevant information concerning every member is given to the administrator. There is a legal requirement on employers to provide any information requested by schemes for the calculation of members' benefits.

Although details of salary changes may only be given once a year, entry to schemes will often take place at any time during the year (for example, if the employer is using their scheme to automatically enrol new employees). A consolidated list of changes may therefore be provided at the annual renewal. If the scheme is not being used for automatic enrolment and entry to the scheme takes place annually, completed application forms for new members should be provided as part of the annual updating exercise.

In addition to revised salary details, the information required could include details of all member contributions paid, changes in part time hours, details of any periods of temporary absence or maternity, paternity or adoption leave etc.

Before the exercise is completed, a number of reconciliations are usually carried out. For example, that:

- The sum of the individual contributions equals the amount paid during the year.
- The total number of active members agrees with the employer's records.
- All members recorded as being 'active' have paid contributions during the year if it is a contributory scheme.
- Leaver forms have been received for all leavers.

Members should be given regular information about the benefits they are accruing. The disclosure regulations give members the right to request, once a year, a statement of their accrued benefits payable from normal pension age.

There is a legal requirement for a DC scheme to provide an annual benefit statement automatically. This also applies to any DC benefits within DB schemes including AVCs and any DC underpin. The statement must include a Statutory Money Purchase Illustration (SMPI) (unless the only DC benefit is an underpin and the trustees determine that the benefits from the underpin are unlikely to be greater than the DB benefits for the member concerned).

The annual benefit statement may also state the pension input amount (that is the increase in value of the member's benefits over the previous year for Annual Allowance purposes). This information can help members determine whether or not they may be subject to an annual allowance charge.

From 1 October 2022, the Occupational and Personal Pension Schemes (Disclosure of Information((Statements of Benefits: Money Purchase Benefits) (Amendment) Regulations 2021 ("the 2021 Regulations") introduced new requirements for trustees/managers of DC pension schemes that provide money purchase benefits only and that are used for automatic enrolment. The 2021 Regulations amend the Disclosure of Information Regulations 2013 to reflect the new requirements. The amendments require trustees/managers of schemes in scope to provide a simpler annual benefit statement that does not exceed one double-sided sheet of A4 size paper when issuing a paper statement, and the equivalent length if issuing an email or online statement.

The simpler annual benefit statement template is divided into 5 sections and the information on the statement should enable the member to easily understand:

- How much money they have in their pension pot and the amount of money they have saved in the statement year
- How much money they could have when they retire, and
- What they could do to give themselves more money at retirement.

The 5 sections are:

1. Member and Pension Scheme details
2. How much money the member already has in their pension pot
3. How much money the member could have when they retire
4. What the member could do to give themselves more money at retirement
5. Pension plan details and how the member can use their money.

In addition, as well as when the member joins the scheme, trustees must also provide members who have DC funds invested in a lifestyle arrangement with a statement explaining what lifestyling is and the advantages and disadvantages of lifestyling. This must be provided between 5 and 15 years prior to the member's retirement age (ideally coinciding with when member's funds start switching into less volatile funds).

7.5.2 Ad hoc Events

Although the annual renewal exercise represents the core update of scheme records, administrators also need to update records on an ad hoc basis when certain events occur, such as new entrants and leavers, retirements or deaths of existing members, changes of members' marital status, address or other data.

7.5.3 Members Receiving Pension

Pensions are increased in payment as described in Part 5, Chapter 3.4. Increases may take place for all pensioners on the same date or may be effective on each member's anniversary of retirement. As different elements of a member's pension may increase at different rates, administrators must ensure that they maintain sufficient records for them to identify the amount of each element.

Summary

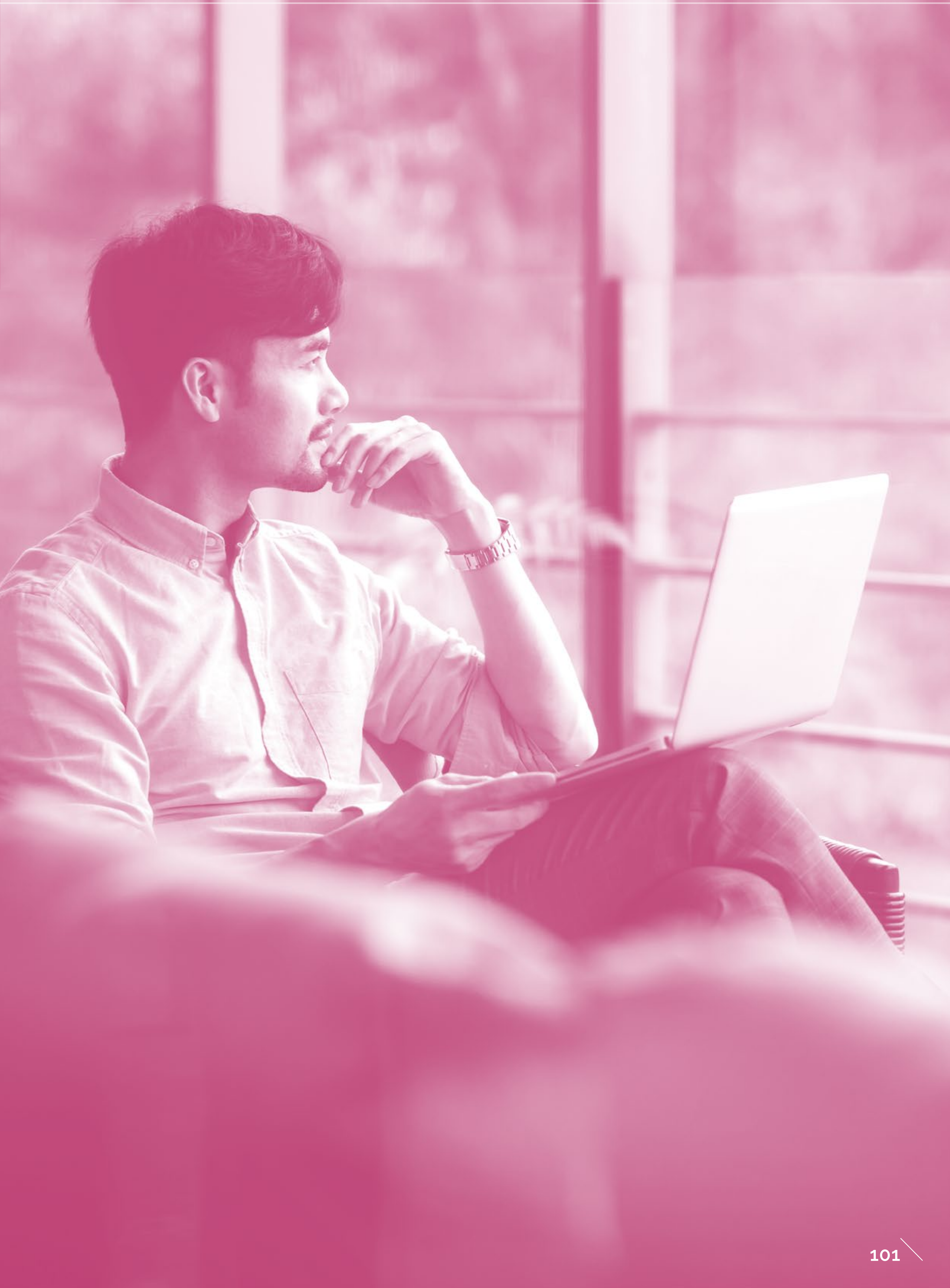
This Chapter has covered the issue of communication and renewals. This has included best practice as well as the requirements imposed by the disclosure regulations.

Self Test Questions

- What factors should trustees take into account when they communicate with members of the scheme?
- List the 3 methods schemes can use to provide information to members.
- Briefly describe the disclosure of information regulations.
- What are the additional communication requirements for trustees/ managers of money purchase only schemes used for automatic enrolment from 1 October 2022.

Part 4

ALLOWANCES



OVERVIEW

This part comprises 3 chapters.

It covers the tax reliefs available on pension savings, the limits which have been imposed on these and the various changes that have taken place over time. Part 4 also examines the different protection measures that have been introduced because of these changes.

Chapters 1 and 2 outline the annual allowance and the lifetime allowance respectively. Chapter 3 explains the various types of protection and the taxation of high earners.

CHAPTER 1

ANNUAL ALLOWANCE

1.1 INTRODUCTION

A key element of the current pensions tax regime is the Annual Allowance. This is the maximum amount of pension savings an individual can make each year to registered pension schemes without incurring a tax charge (known as the Annual Allowance charge).

Prior to 6 April 2006, there were no rules on how much benefit could accrue during the year, but there were complex rules governing the maximum contributions that could be paid in. These rules were different for employer and employee contributions, and depended on whether the scheme was an occupational scheme or a personal pension scheme. Furthermore, some of these rules depended on the funding level of the scheme or the individual's age and earnings. The Annual Allowance completely replaced all these rules.

The Annual Allowance is an upper threshold for the amount of new pension savings each year that a member can accrue before being subject to a tax charge. For defined benefit (DB) schemes, it is the increase in the value of any benefits accrued during the year that is tested against this limit. For defined contribution (DC) schemes, it is the total contributions paid by both the employee and employer that is tested. If the value of new benefits in any year exceeds the Annual Allowance, then the member is subject to a tax charge on the excess. The amount that is tested against the Annual Allowance in any year is called the 'pension input amount'.

The period over which the Annual Allowance is assessed is called 'the pension input period'. In the past, this need not have been a tax year, although that was the period used by many schemes. Within certain limits, the Scheme Administrator (or member in the case of a DC arrangement) could nominate a different pension input period for any given scheme. From 6 April 2016, the pension input period is aligned with the tax year for all schemes.

Since someone might be a member of more than one pension scheme or arrangement, it is possible for there to be more than one pension input amount. In that case, the total pension input amounts accrued over the tax year in question are aggregated and measured against the Annual Allowance.

The initial level of the Annual Allowance was £215,000. This has changed in accordance with the table shown below:

TAX YEAR	ANNUAL ALLOWANCE
2006/07	£215,000
2007/08	£225,000
2008/09	£235,000
2009/10	£245,000
2010/11	£255,000
2011/12	£50,000
2012/13	£50,000
2013/14	£50,000
2014/15	£40,000
2015/16	£80,000, but see note below
2016/17	£40,000
2017/18	£40,000
2018/19	£40,000
2019/20	£40,000
2020/21	£40,000
2021/22	£40,000
2022/23	£40,000
2023/24	£60,000
2024/25	£60,000

The Finance Act 2011 reduced the Annual Allowance to £50,000 with effect from 2011/12, prompted by two main factors:

The state of the public finances and the consequent need to raise revenue.

The fear that the 50% additional rate of Income Tax introduced in the 2010/11 tax year would prompt high earners to put excessive amounts into pension schemes to avoid (or defer) tax.

As well as reducing the amount of the Annual Allowance, the Finance Act 2011 also made various other changes, principally:

- The Annual Allowance charge was originally at the rate of 40%. For the 2011/12 tax year and subsequent years, the charge is calculated by deeming the excess pension input amount above the Annual Allowance to be part of the individual's earnings. This means that the excess pension input amount will be taxed at the individual's marginal rate of tax. The amount of the excess pension input amount:
  - over the individual's higher rate limit will be taxed at 45% (50% for the 2011/12 and 2012/13 tax years)
  - over the individual's basic rate limit but below the member's higher rate limit will be taxed at 40%
  - below the individual's basic rate limit will be taxed at 20%
- Before the 2011/12 tax year, for any given pension arrangement, the Annual Allowance did not apply in the year in which the member started to draw all his benefits from that arrangement. The Annual Allowance also did not apply to any member who had Enhanced Protection. For inputs applicable to the 2011/12 and subsequent tax years, the exemption for those who take all their benefits does not apply (except on death or in certain cases of ill health), and the exemption for members with Enhanced Protection is removed
- Where a chargeable amount arises in the 2011/12 or subsequent tax years, any unused relief attributable to the previous three tax years (i.e. the difference between the pension input amount in those years and the relevant Annual Allowance, for this purpose taken to be £50,000 for the tax years before the 2011/12 tax year) can be carried forward and used to offset some or all of the excess pension savings made in the current tax year. The effect of this is to limit the impact of the reduced Annual Allowance on those whose pension input amount is normally well below the Annual Allowance but who may experience a 'spike' in their pension input amount due to a one-off event, such as a promotion (particularly members of final salary schemes with long service) or an augmentation to their benefits on retirement or redundancy
- Special rules apply to testing pension input amounts that arose in so called 'straddling Pension Input Periods' (PIP). These are periods that started before 14 October 2010 (the date on which the new rules regarding the reduced Annual Allowance regime was announced) and which ended on or after 6 April 2011 (therefore giving rise to a pension input amount that fell to be tested in the 2011/12 tax year). The effect of these rules is that there will be no charge in relation to a pension input amount arising in a straddling PIP provided that:
  - The total pension input amount during the period does not exceed the old limit of £255,000.
  - The pension input amount which was made during the period after the date of the announcement (14 October 2010) does not exceed the new limit of £50,000.

The Finance Act 2013 reduced the Annual Allowance further, from £50,000 to £40,000, with effect from the 2014/15 tax year.

The Summer Budget 2015 also announced changes to the Annual Allowance (AA) for high earners. The Government cut pensions tax relief for these individuals by reducing the Annual Allowance on a 'tapered basis' (see Part 4 Chapter 3.8.2).

In the Spring Budget 2023, the government announced that the Annual Allowance would increase from 6 April 2023 to £60,000.

1.2 PENSION INPUT AMOUNT FOR DEFINED CONTRIBUTION SCHEMES

In a DC scheme, the pension input amount is, broadly speaking, the total 'relievable contribution' paid by or on behalf of the member, together with any contribution paid in respect of the member by the employer, in the pension input period.

This includes any AVCs paid by the member but does not include transfers into the scheme from other arrangements.

The Taxation of Pensions Act 2014 introduced a Money Purchase Annual Allowance (MPAA) with effect from the 2015/16 tax year. The Money Purchase Annual Allowance limit was £10,000 but this was reduced to £4,000 from 6 April 2017. It was increased back up to £10,000 from 6 April 2023.

It only applies to pension input amounts in DC arrangements when an individual has flexibly accessed a DC arrangement (the main ways being payment of an Uncrystallised Funds Pension Lump Sum or income drawn from a flexi-access drawdown). It does not apply if an individual has not flexibly accessed a DC arrangement (for example, being paid either a small lump sum or pension commencement lump sum).

Individuals who have not flexibly accessed their DC arrangement will still be subject to the standard Annual Allowance (currently £60,000) for pension input amounts into a DC arrangement.

1.3 PENSION INPUT AMOUNT FOR DEFINED BENEFIT OR CASH BALANCE SCHEMES

The pension input amount operates in a different way for DB schemes. In these arrangements, the value of a person's benefits (i.e. their accrued benefit) at the end of the pension input period is compared with the value of their benefits at the end of the previous pension input period. Subject to certain adjustments, the difference is the pension input amount for the period.

For inputs relating to the 2010/11 and earlier tax years, for the purpose of valuing the pension benefits at the start and end of the pension input period, a factor of ten is used. This is shown in the following example:

Example

Maxine's accrued pension in the Colourboxx Final Salary Plan at the end of the previous input period on 5 April 2007 was £40,000 p.a. At the end of the current input period on 5 April 2008 her accrued pension was £63,000 p.a. (this reflects one-year's extra service, but also her salary increase over the year). This was an increase of £23,000 p.a., which is then multiplied by ten to give a pension input amount of £230,000. She has no other pension arrangements.

As the total pension input amount exceeds the Annual Allowance of £225,000 in the 2007/08 tax year, her pension rights are deemed to have exceeded the Annual Allowance and so Maxine is charged an Annual Allowance tax charge of £2,000 (i.e. £5,000 x 40%).

Adjustments are made to the figures to take account of any transfers in or out of the scheme and also any pension debits or credits resulting from a divorce.

Where a member of a DB scheme is no longer an 'active member', and so is no longer accruing benefits, there is a further adjustment that is intended to ensure that the normal annual revaluation given in such circumstances to protect against erosion by inflation does not contribute to the total pension input amount.

For inputs relating to the 2011/12 and later tax years, 10 is replaced by 16 as the valuation factor, and the inflation protection is extended to active members. Deferred members whose benefits' revaluation does not exceed the increase in the CPI (or any higher rate written into the scheme rules as they stood on 14 October 2010) will be deemed as having no pension input amount. (However, the rules governing this are some what complicated and do not always work.)

Where an individual is subject to the Money Purchase Annual Allowance, they are still entitled to the alternative Annual Allowance for 'other inputs'. The 'alternative' Annual Allowance is found by subtracting the Money Purchase Annual Allowance from the amount of the Annual Allowance for the tax year. For example, for the 2024/25 tax year, the alternative Annual Allowance will be £50,000 (£60,000 less £10,000) for someone who is not subject to the tapered Annual Allowance (see Part 4 – Chapter 3.9.2).

1.4 THE ANNUAL ALLOWANCE AND TAX RELIEF

A person may pay an unlimited amount into a registered pension scheme in any tax year but will enjoy tax relief only up to the greater of 100% of their UK taxable earnings and £3,600 (for a scheme operating on a 'relief at source' basis).

Contributions in excess of the Annual Allowance will have received tax relief when paid, provided the individual has sufficient earnings, but the individual will then be subject to a tax charge (assuming they do not have sufficient carry forward to offset the excess contributions). The tax charge effectively claws back, in a broad- brush manner, the relief that was first granted on the contributions in excess of the Annual Allowance. If someone were to pay contributions to a money purchase arrangement that exceeded both their earnings and the Annual Allowance, the tranche of contributions in excess of the greater of (i) the Annual Allowance and (ii) their earnings would not have received tax relief when paid. No Annual Allowance charge is therefore due on this tranche of contributions because no tax relief has been granted in the first place and so there is no relief to claw back.

The following example demonstrates these points:

Example

Lorraine earns £20,000 per year and uses her savings to pay a total of £40,000 into an occupational DC pension scheme in August 2022. She will be granted tax relief on the first £20,000 of her contribution (100% of earnings) but will have received no tax relief on the next £20,000. Her pension input period is the same as the tax year. Lorraine's contribution has not exceeded the Annual Allowance of £40,000, so no Annual Allowance tax charge is due.

Lorraine changes jobs in August 2024 and now earns £70,000 and decides to pay her entire earnings into an occupational DC scheme. She faces an Annual Allowance charge on £10,000 (£70,000 -

£60,000) of the contributions made. This is because all of the £70,000 contribution would have received tax relief when it was paid, but only £60,000 is within the Annual Allowance. In effect, the tax relief on the remaining £10,000 is clawed back via the Annual Allowance tax charge.

In the very unlikely event that Lorraine had chosen to make a contribution of £90,000, she would, in addition to the Annual Allowance charge she faces on £10,000 of the contributions, have already paid tax on the remaining £20,000 of contributions. Therefore, only £60,000 (the amount within the Annual Allowance) in effect receives tax relief; the contribution up to the remainder of earnings (£30,000) would lead to an Annual Allowance charge (which would, broadly speaking, claw back the tax relief) and the additional amount over and above her earnings (£20,000) that she chooses to pay as a contribution will not be subject to tax relief. (Note that the contribution of £20,000 in excess of her earnings would not contribute towards the Annual Allowance charge, because no tax relief was given on it).

An employer will also be allowed to pay an unlimited amount into a pension scheme on behalf of an employee but, again, any payment above the Annual Allowance figure would render the individual liable to a tax charge.

Any personal contributions are added to the employer's contributions when testing against the Annual Allowance, so that if Lorraine in the example above pays a contribution of £10,000 into her pension, her employer can pay a further £50,000 into her pension before the £60,000 limit for the 2024/25 tax year is reached.

1.5 SCHEME PAYS

The member is liable for any Annual Allowance tax charge that may be due. However, for the 2011/12 and following tax years, provided certain conditions are satisfied, the member has the right to require the

scheme to pay the charge on their behalf. In return, the scheme will make an appropriate reduction to the member's benefit entitlement. In this case, the Scheme Administrator (normally the trustees or manager of the scheme) and the member have a joint and several liability for the charge.

The conditions that need to be satisfied if the member is to have the right to require the scheme to pay the tax charge are:

- The member's Annual Allowance charge liability for the tax year must exceed £2,000

The pension input amount under the scheme must exceed the Annual Allowance for that year (e.g.£60,000 in the 2024/25 tax year) – the tapered Annual Allowance is ignored for the "Scheme Pays" conditions test.

The member must make the request by means of an irrevocable election made in a prescribed form and this request must have been received by the scheme on or before the deadline. The deadline for this is 31 July after the end of the following tax year (so for example the election would have to be made by 31 July 2025, for an Annual Allowance charge relating to the tax year ending 5 April 2024). In relation to the 2011/12 tax year, the first year of operation, the deadline was extended from 31 July 2013 to 31 December 2013.

Where the member has an Annual Allowance liability but one or more of the above conditions is not satisfied, the scheme can decide voluntarily to pay the member's charge on his/her behalf. As in the case of 'statutory' or 'mandatory' scheme pays, the member's benefit entitlement will be reduced appropriately. However, in the case of voluntary scheme pays, the liability for the Annual Allowance charge remains solely with the member and the deadline is the following 31 January, to tie in with the member's Self-Assessment deadline for that tax year.

1.6 PENSIONS SAVINGS STATEMENTS

Where a member of a scheme has benefits within that scheme that exceed the Annual Allowance (as opposed to the tapered Annual Allowance), the trustees or managers are required to automatically provide a 'pension savings statement' within six months from the end of the tax year. No account is taken of any unused relief carried forward or of any pension input the member has in other schemes (neither of which the trustees or manager can be expected to know about).

The trustees or manager must also provide a 'pension savings statement' where they believe the individual has flexibly accessed a DC arrangement after 6 April 2015 and the individual's DC pension input amounts under the scheme for the tax year are more than the Money Purchase Annual Allowance (currently £10,000).

The pensions savings statement will show the pension input amount arising in the scheme during the pension input period, together with the corresponding amounts for each of the previous three tax years.

Members who have not exceeded the Annual Allowance in a particular scheme will not receive a pensions savings statement automatically, but can nevertheless request one. If they do, the pension scheme is required to provide one by the later of (i) three months from the member's request and (ii) six months from the end of the tax year.

There are also disclosure requirements that apply to employers, who must provide the scheme with sufficient information to calculate the pension input amounts of its employees by 6 July following the end of the tax year.

For the 2010/11 tax year only, employers and pension schemes were given an additional 12 months (i.e. to 6 July 2013 or 6 October 2013 respectively), to provide the required information.

Summary

This Chapter has explained the Annual Allowance and how it impacts administration.

Self Test Questions

- Describe the principles behind the Annual Allowance
- List the conditions a member must satisfy in order to have the right to use the Scheme Pays facility
- Outline the changes made by the Finance Act 2011 to the Annual Allowance
- Describe the transitional arrangements put in place for the 2015/16 tax year
- Write a brief note on the Pensions Savings Statements

CHAPTER 2

PENSION TAX REGIME

2.1 INTRODUCTION

Broadly, the Lifetime Allowance was an allowance of the total pension rights an individual could accrue in their life in registered pension schemes while still benefiting from tax relief. The Lifetime Allowance was introduced at the level of £1.5 million and changed each subsequent year as shown in the table below.

TAX YEAR	ANNUAL ALLOWANCE
2006/07	£215,000
2007/08	£225,000
2008/09	£235,000
2009/10	£245,000
2010/11	£255,000
2011/12	£50,000
2012/13	£50,000
2013/14	£50,000
2014/15	£40,000
2015/16	£80,000, but see note below
2016/17	£40,000
2017/18	£40,000
2018/19	£40,000
2019/20	£40,000
2020/21	£40,000
2021/22	£40,000
2022/23	£40,000
2023/24	£60,000
2024/25	£60,000

Under transitional arrangements, some individuals were able to opt for 'protection' against some or all of any Lifetime Allowance Charge, in which case different rules apply (see Part 4 Chapter 3).

When the Lifetime Allowance for the 2012/13 and subsequent tax years was reduced to £1.5m by the Finance Act 2011, individuals could elect to continue to be subject to the higher £1.8m limit previously in place (so called 'fixed protection') but only provided certain conditions are met including that they had no further 'benefit accrual' under any registered scheme on or after 6 April 2012.

When the Lifetime Allowance was reduced from £1.5m to £1.25m with effect from the 2014/15 tax year by the Finance Act 2013, further forms of 'protection' for members with large pension rights were introduced ('fixed protection 2014' and 'individual protection 2014').

The Lifetime Allowance was further reduced from £1.25m to £1m with effect from the 2016/17 tax year by the Finance Act 2016. Alongside the reduction in the Lifetime Allowance, to ensure the change is not retrospective and to protect savers who think they may be affected, further protections were introduced ('fixed protection 2016 and 'individual protection 2016').

The Finance Act 2016 also set out that the Lifetime Allowance will be increased in line with the Consumer Prices Index from the 2018/19 tax year onwards.

Legislation was introduced in Finance Act 2021 to remove the annual lifetime allowance link to the Consumer Price Index increase for the next 5 fiscal years. This change maintained the standard lifetime allowance of £1,073,100 for tax years 2021/2022 to 2023/2024.

In the Budget on 15 March 2023, the Government announced several significant changes to the Lifetime Allowance, in particular:

- The Lifetime Allowance charge would be abolished with effect from 6 April 2023
- The Lifetime Allowance itself would be removed from the pensions tax legislation at a later point.

For the 2023/24 tax year, the Lifetime Allowance remained at £1,073,100 and Lifetime Allowance checks still needed to be carried out at benefit crystallisation events (see section 2.2). However, as mentioned above, there was no Lifetime Allowance charge.

Taxation of any lifetime allowance excess lump sum, serious ill-health lump sum, defined benefits lump sum death benefit and uncrystallised funds lump sum death benefits above the lifetime allowance changed from a 55% tax charge to taxation at an individual's marginal rate of income tax.

The Lifetime Allowance was fully abolished from tax year 2024/25, but the government's retained a limit on the maximum amount of tax-free lump sum payments. There are many technical complexities involved in the transition, but the key changes are outlined below.

With the removal of the LTA, two new allowances were introduced:

- **Individual's Lump Sum Allowance (LSA)**

  The amount of tax-free lump sums that can be paid in a member's lifetime is limited by the LSA.

  The LSA is equal to £268,275 for most members, but can be higher for members with LTA protections.

  £268,275 is equal to 25% of the standard LTA at the point it was abolished (i.e. 25% of £1,073,100 = £268,275).

  Broadly speaking, the LSA is used up when a lump sum is paid in the member's lifetime that is tax-free (either wholly or in part).

  Any lump sum paid in excess of the LSA will be subject to income tax at the member's margin rate.

- **Lump Sum and Death Benefit Allowance (LSDBA)**

  The amount of tax-free lump sums that can be paid both in the member's lifetime and on death is limited by the LSDBA.

  The LSDBA is equal to £1,073,100 for most members, but can be higher for members with LTA protections.

  Broadly speaking, the LSDBA is used up whenever the member uses up any part of their LSA during their lifetime or a lump sum is paid tax-free (either wholly or in part) on the member's death . On death, anything paid as a lump sum above the remaining LSDBA will be taxed at the beneficiary's marginal rate.

Benefits taken before 6 April 2024 are taken into account and will reduce the available LSA and LSDBA by 25% of the total LTA previously used in most cases*****. However, if the member did not take the full amount of tax-free cash at retirement they can apply for a transitional tax-free cash certificate (TTFAC) which means that, broadly speaking, their available LSA and LSDBA is based on the amount of tax-free cash that they actually did take.

*****In certain cases, the LSDBA will be reduced by 100% of the total LTA previously used

This is shown in the example below:

Example

Harry started taking his defined benefit pension of £25,000 a year when the LTA was £1,000,000. This had a value of £25,000 x 20 = £500,000, which was equal to 50% of the standard LTA.

This means that his future tax-free cash is reduced by 50% of £268,275 i.e. £134,138. His LSDBA is now £938,963

However, Harry did not take any tax-free cash from this pension when he retired. He also has not taken any tax-free cash from any other pension schemes. If he applies for a transitional tax-free cash certificate, he can still take up to the full £268,275

Before 2024/25, the general rule was that whenever a member takes benefits from a registered pension scheme, and on certain other occasions (so called Benefit Crystallisation Events - see Part 4 Chapter 2.1), part of their Lifetime Allowance is used up. When there is no longer any Lifetime Allowance remaining, any further benefits put into payment attracted an additional tax called the Lifetime Allowance Charge (in respect of Benefit Crystallisation Events that happened before 6 April 2023).

The Lifetime Allowance Charge (removed with effect from tax year 2023/24) was set at a level that was broadly intended to remove the tax advantages that the person has previously received in relation to those benefits because of their membership of a registered pension scheme. The overall effect is that benefits with total value up to the Lifetime Allowance enjoyed the tax advantages of a registered pension scheme, but the taxation of any benefits above this level was intended to be broadly neutral.

The level of the Lifetime Allowance Charge depended on whether the benefits subject to the charge were taken in pension or lump sum form, as the following example illustrates:

Example

Alan, a member of Colourboxx, has pension rights valued at £2.8 million in May 2011 when he retires. He has not applied for protection.

He has not previously put any benefits into payment so has not used up any Lifetime Allowance. The full Lifetime Allowance of £1.8 million applicable to the 2011/12 tax year is available.

When he retires, if Alan puts all his benefits into payment then £1 million, i.e. the excess of his pension rights over the Lifetime Allowance, is liable to the Lifetime Allowance Charge.

If he elects to take the £1 million as a lump sum, then the recovery charge will be 55%, meaning that there will be a tax bill in this instance of £550,000. If he elects to draw the £1 million as a pension, then the up-front recovery charge is only 25% but Alan will also pay income tax on the pension once in payment. Based on an income tax rate of 40%, the overall tax liability should work out to be the same, as illustrated by the following calculations:

Upfront Lifetime Allowance Charge:
25% x £1,000,000 = £250,000

Excess amount used to provide a pension:
£1,000,000 - £250,000 = £750,000

Gross pension provided*:
£750,000 / 20 = £37,500 p.a.

Income Tax at 40% on the pension:
40% x £37,500 = £15,000 p.a.

Present value of £15,000 p.a. tax:
£15,000 x 20 = £300,000

Equivalent total tax:
£250,000 + £300,000 = £550,000

- Assume for the purposes of the illustration that each £1 p.a. of pension costs £20 to buy.

The tax bill is the joint and several liability of Alan and the Scheme Administrator. What this means is that, assuming Alan opts for the lump sum and the Scheme Administrator settles £300,000 of the liability, then HMRC can pursue both Alan and the Scheme Administrator for the remaining £250,000. In practice, this means that the Scheme Administrator will normally want to ensure that any Lifetime Allowance liability has been met before the benefits are paid out.

2.2 BENEFIT CRYSTALLISATION EVENTS (BCES) – pre-6 April 2024

A BCE was an event in a registered scheme which triggers a test of the member's benefits against the Lifetime Allowance. There were 13 BCEs. These were:

BCE1	Where funds are designated to provide a member with a drawdown pension
BCE2	A scheme pension coming into payment
BCE3	An increase to a pension in payment exceeding certain permitted annual indexation levels (broadly, the greater of 5% and the increase in the Retail Prices Index)
BCE4	A member of a DC scheme buys a 'lifetime annuity' from an insurance company
BCE5	A member of a DB arrangement reaching age 75 without having put all of their scheme pension or lump sum entitlements into payment
BCE5a	A member of a money purchase arrangement reaching age 75 with unused funds still in a drawdown pension fund or a flexi-access drawdown fund
BCE5b	A member of a money purchase arrangement reaching age 75 with unused funds
BCE5c	A member dies before their 75th birthday and unused funds remaining at death are designated, on or after 6 April 2015 but before the end of a two-year period, to a dependant's flexi-access drawdown pension or nominee's flexi-access drawdown pension
BCE5d	Where a member dies before their 75th birthday and unused uncrystallised funds remaining at death are used to provide entitlement to a purchased dependants' or nominees' annuity. The death must be on or after 3 December 2014 with the entitlement arising on or after 6 April 2015 but before the end of a two-year period.
BCE6	The payment of a Pension Commencement Lump Sum or certain other lump sums
BCE7	Payment of most lump sum death benefits on the death of a member
BCE8	The transfer of pension rights to a Qualifying Recognised Overseas Pension Scheme
BCE9	Miscellaneous events as set out in regulations, principally certain lump sum payments which do not fall under BCE6 for technical reasons.

Each time a test was made, part of the person's Lifetime Allowance was deemed to have been used up (see example below). If there was insufficient Lifetime Allowance remaining at the time of the test, then a Lifetime Allowance charge became payable.

Example

- Alan crystallises benefits with a capital value of £150,000. The standard Lifetime Allowance at that point is £1.5 million, so the percentage used up is 10%. If Alan had not crystallised any other benefits previously, he will have 90% of his Lifetime Allowance still available for the next BCE.
- The same process occurs when Alan crystallises benefits at a future date.
- Alan now crystallises a further £450,000 when the standard Lifetime Allowance is £1.8 million. Alan has used up a further 25% of the standard Lifetime Allowance. In total, Alan has used up 35% (10%+ 25%) of his Lifetime Allowance.

The percentage of the standard Lifetime Allowance used up at a particular BCE remained constant year by year even though the standard Lifetime Allowance changed in subsequent tax years. So, the 10% ofthe standard Lifetime Allowance used up in the example above when the standard Lifetime Allowance was£1.5 million remains constant at 10% in the later year when the allowance has risen to £1.8 million.

This is to ensure that individuals will face the same real aggregate Lifetime Allowance on their total pension rights built up with tax relief, irrespective of:

- When they choose to take their pension benefits and the type of benefits they become entitled to, and
- Whether benefits are taken from one scheme or from multiple schemes.

2.3 RELEVANT BENEFIT CRYSTALLISATION EVENTS (RBCES)

RBCEs replaced BCEs with effect from 6 April 2024. These are split into "relevant lump sums", which are lump sums made in the individual's lifetime, and "relevant lump sum death benefits", which are lump sums paid after the individual has died.

Post the abolition of the LTA, only lump sum payments will be tested against the LSA and LSDBA limits. No test is triggered when pension benefits are taken as income such as annuities.

Relevant lump sums which are tested against the LSA include pension commencement lump sums, standalone lump sums, and uncrystallised funds pension lump sums. Small lump sums and trivial commutation lump sums are not RBCEs. Serious ill health lump sums are tested against the LSDBA but not the LSA.

Where multiple RBCEs happen on the same day the member can decide the order in which they are deemed to have occurred.

2.4 VALUING PENSION RIGHTS

In order to determine whether a person's total pension rights exceeded the Lifetime Allowance, they needed to be valued. HMRC has, therefore, laid down a set of criteria for valuing pension rights when they crystallised:

- For a DC scheme, and provided the money purchase pot is not used to provide a scheme pension, the value of the pension rights is taken as the fund value at the time of crystallisation
- For a DB scheme, the value is the amount of any cash sum taken plus 20 x the amount of the starting pension. The value for a money purchase pot used to provide a scheme pension is also 20 x the starting pension

If a person is receiving a pension that was put into payment prior to 6 April 2006 (that is, under the previous tax regime) then this was also tested. Such 'pre-commencement pensions' were tested at the time of the first post 6 April 2006 Benefit Crystallisation Event. The value of the pension is then deducted from the member's Lifetime Allowance. For this purpose, pre-commencement pensions are valued by multiplying the pension in payment at the time of the first Benefit Crystallisation Event by 25. This is shown by the following example:

Example

Suppose Alan was already receiving a pension of £10,000 p.a. on 5 April 2006 from another pension scheme. In May 2011, when he retired from the Colourboxx scheme, suppose this had increased to £11,500 p.a.

When he put his Colourboxx benefits into payment, the Lifetime Allowance that Alan would be tested against would be reduced by 25 x £11,500 = £287,500

Standard Lifetime Allowance:	***£1,800,000***
Value of pre-commencement pension:	***£287,500***
Reduced Lifetime Allowance:	***£1,512,500***
Value of benefits coming into payment	***£2,800,000***
Excess subject to Lifetime Allowance Charge	***£1,287,500***

Summary

This Chapter has explained the Lifetime Allowance and how it operates.

Self Test Questions

- Explain the changes to the Lifetime Allowance since 6 April 2006
- List the 13 Benefit Crystallisation Events
- Distinguish how you would value pension rights between DB and DC schemes
- Describe how a member's remaining LSA is calculated if they took benefits before 6 April 2024

CHAPTER 3

PROTECTION AND TAXATION OF HIGH EARNERS

INTRODUCTION

This Chapter explains the concept of protection and outlines how it operates. It also covers the pension taxation of high earners.

Whenever HMRC has changed the rules, they have introduced protections to ensure individuals who had pension savings higher than the Lifetime Allowance were not unfairly penalised. Over the years, this has resulted in a number of different forms of protection being put in place.

3.1 PRIMARY AND ENHANCED PROTECTION

At 6 April 2006, there were a few individuals who had already accrued benefits with a value of over £1.5 million (the level of the LTA at that date), or who expected to do so by the time they retired. Individuals could apply to HMRC for protection from the Lifetime Allowance charge.

The two types of transitional protection available are known as primary and enhanced protection. Members who wished to apply for these types of protection had to do so by 5 April 2009.

- Primary protection was available to members who had already accrued benefits with a value greater than £1.5 million as at 5 April 2006. The value of their accrued benefits at that date (increased as set out below) is protected from the Lifetime Allowance charge, but any further benefits are subject to the charge. HMRC provides these individuals with an enhancement to the standard LTA.
- To maintain the value of primary protection when the standard LTA was reduced from £1.8 million to £1.5 million from 6 April 2012, the enhancement to the LTA is based on the larger of £1.8 million and the standard LTA at the point the member's benefits are paid. This still continues to be the case following the further reductions of the LTA to £1.25 million from 6 April 2014 and to £1 million from 6 April 2016.

Example

A member had accrued benefits at 5 April 2006 which were valued at £2.1 million. This value is 40% higher than the standard LTA at that date. The member applied for primary protection, and HMRC gave him/her an 'enhancement factor' of 0.4.

The member retires on 1 November 2014 when the standard LTA has reduced to £1.25 million but as the member has primary protection, he/she retains the protected amount based on a standard LTA of £1.8m. As a result of their enhancement factor of 0.4, this member's LTA will be £1.8 million x (1 + 0.4) = £2.52 million. Benefits up to £2.52 million in value will not be subject to the Lifetime Allowance charge, but benefits in excess of this amount will be subject to the charge.

- **Enhanced protection** was available to any member, although in practice only members with benefits valued above £1.5 million as at 5 April 2006 are likely to have applied for it. Under enhanced protection, a member's benefits are completely protected from the Lifetime Allowance charge, but no further contributions to DC schemes can be made and the member can only accrue very limited benefits in DB schemes.

3.2 FIXED PROTECTION

As a result of the reduction in the LTA to £1.5 million from 6 April 2012, a further type of protection, known as fixed protection (also referred to as fixed protection 2012), was introduced. Members could apply to HMRC for fixed protection if they thought the value of their benefits would be higher than £1.5 million by the time they came to take them. Applications for fixed protection had to be received by HMRC by 5 April 2012.

Under fixed protection, benefits up to £1.8 million in value are protected from the Lifetime Allowance charge, but benefits in excess of this amount are subject to the charge. Members with fixed protection are not allowed to pay any further contributions to DC schemes and cannot accrue any further benefits in DB schemes apart from an allowance for inflation. Individuals could not apply for fixed protection if they already had primary protection or enhanced protection.

3.3 FIXED PROTECTION 2014

A further version of fixed protection, known as fixed protection 2014, was introduced due to the reduction in the standard LTA to £1.25 million from 6 April 2014. Fixed protection 2014 allows members to protect benefits up to a value of £1.5 million. Members had to apply for fixed protection 2014 before 6 April 2014, with similar restrictions to fixed protection applying on future contributions and benefit accrual. Individuals cannot apply for fixed protection 2014 if they already have primary protection, enhanced protection or fixed protection.

3.4 INDIVIDUAL PROTECTION 2014

As a consequence of the reduction in the LTA from £1.5million to £1.25 million from 6 April 2014, individuals could apply for a new form of pension protection called individual protection 2014. Under individual protection 2014, individuals could protect the value of their accrued benefits as at 5 April 2014, subject to a maximum of £1.5 million. Applications for individual protection 2014 must have been received by HMRC by 5 April 2017. Unlike either fixed protection or fixed protection 2014, members with individual protection 2014 can still accrue further benefits and pay DC contributions, but the additional benefits above the protected amount would be subject to the Lifetime Allowance charge (up to 5 April 2023 – the Lifetime Allowance charge was removed with effect from 6 April 2023, although benefits in excess of the protected amount would be taxed at the member's marginal rate). Individuals could not apply for individual protection 2014 if they already have primary protection.

3.5 FIXED PROTECTION 2016

Fixed protection 2016 was introduced due to the reduction in the standard LTA to £1 million from 6 April 2016. Fixed protection 2016 allows members to protect benefits up to a value of £1.25 million. Restrictions apply on future contributions and benefit accrual, and these are broadly similar to those in place for fixed protection and fixed protection 2014. There is no deadline for when individuals can apply for fixed protection 2016. However, individuals cannot apply for fixed protection 2016 if they already have primary protection, enhanced protection, fixed protection 2012, or fixed protection 2014.

Members could apply if they opted out of any workplace schemes by 5 April 2016 and have not added to their pension savings since. They can still apply for fixed protection 2016 if they already have individual protection 2014. Fixed protection 2016 will be dormant until they lose their previous protection. To apply, they will need a Government Gateway user ID and password to apply.

3.6 INDIVIDUAL PROTECTION 2016

Individual protection 2016 was also introduced as a result of the reduction in the standard LTA to £1 million from 6 April 2016. Individual protection 2016 allows individuals to protect accrued benefits at 5 April 2016, providing the value exceeds £1 million, by providing a personalised LTA equal to either the value of the accrued rights at 5 April 2016 or £1.25 million if higher. As with fixed protection 2016, there is no deadline for when individuals can apply for individual protection 2016. However, individuals cannot apply for individual protection 2016 if they already have primary protection or individual protection 2014.

Members could apply if the value of their pension savings were worth more than £1 million on 5 April 2016. It will stay dormant until they lose or give up any previous protection. They will need a Government Gateway user ID and password to apply.

3.7 LOSING PROTECTION

Members need to notify HMRC if they lose their lifetime allowance protection. Members will lose enhanced protection where:

- Relevant benefit accrual has occurred.
- A transfer that is not permitted has occurred.

If enhanced protection is lost because a non-permitted event has occurred, members must notify HMRC within 90 days of the occurrence. If a member fails to notify HMRC within the 90-day period, there will be a financial penalty.

Primary protection cannot be given up. However, members will have their primary protection reduced or lose it entirely if after 5 April 2006 they become subject to a pension debit as a result of a pension sharing order following their divorce. When a member has become subject to a pension debit, they must notify HMRC. If primary protection has not been lost due to the pension debit, HMRC will issue a new certificate showing the reduced primary protection factor.

Members with individual protection (that is, either IP 2014 or IP 2016) who become subject to a pension debit as a result of a pension sharing order may have their level of protection reduced or lose protection altogether.

Prior to the Budget on 15 March 2023, members lost their fixed protection (FP 2012, FP 2014 or FP 2016) where:

- Benefit accrual had occurred.
- A transfer that is not permitted had occurred.
- There had been a transfer of sums and assets in an arrangement they had under a registered pension scheme that is not a permitted transfer.
- They had made a new arrangement under a registered pension scheme other than in permitted circumstances.

An individual who applied for enhanced protection or fixed protection 2012, 2014 or 2016 before 15 March 2023 and had received a valid certificate/reference number can have a 'protection cessation event' on or after 6 April 2023 and will not lose their protection. However, individuals who make a successful late application for enhanced protection or fixed protection 2012, 2014 or 2016 on or after 15 March 2023, will be subject to all the existing rules for 'protection cessation events'. Such individuals will be entitled to a higher pension commencement lump sum (PCLS).

Members are responsible for telling HMRC that their fixed protection no longer applies. This must be done within 90 days of the day on which they could first reasonably be expected to be aware that they had lost their fixed protection. They will need to provide the following to HMRC:

- full name, address, and National Insurance number
- the exact date that they lost protection
- the reason why they lost protection (for example benefit accrual, auto enrolment)
- the type of pension arrangement (defined contribution or defined benefit)
- their original certificate (if they still have it), however original certificates were not issued for either IP 2016 or FP 2016.

As a result of the changes to pensions tax legislation to remove the lifetime allowance tax charge from 6 April 2023, individuals who have enhanced protection with lump sum protection will continue to be entitled to a larger PCLS, however the maximum PCLS is restricted to the maximum that they could take on 5 April 2023.

3.8 OTHER ENHANCEMENTS

There are also a number of other enhancement factors that may be applicable for members who either have overseas service or benefits, or who are entitled to a pension credit following pension sharing on divorce. The aim is to prevent members in this position being taxed unfairly – for example, a member of a registered pension scheme who has benefits from overseas service may not have received UK tax relief on their contributions, and so it would be unfair to test the member's benefits against the standard LTA.

Applications to HMRC for these enhancements are not subject to the deadlines which apply to primary, enhanced, fixed protection, fixed protection 2014 or individual protection 2014. Instead, the deadlines differ depending on the type of enhancement for which the member is applying.

In the past, where HMRC accepted an individual's application for protection, they issued a protection certificate. HMRC launched their new online service for applying for protection in July 2016, and members who want to apply for protection will have to use this service. Members will no longer receive paper certificates with their protection details, as they will be able to view their protection details online and print this information where necessary.

3.9 PENSIONS TAXATION OF HIGH EARNERS

3.9.1 2009/10 & 2010/11

In the 2009 Budget, the Government announced a proposal that from April 2011 pensions tax relief for those with high incomes (initially proposed to be £150,000, then reduced to £130,000) would be limited to tax relief on their pension savings at the basic rate only.

Although these proposals were subsequently abandoned, temporary "anti-forestalling" measures were put into place that affected high earners during the 2009/10 and 2010/11 tax years.

Special Annual Allowance

There was a concern that high earning individuals might try to forestall the proposed limit for high earners by arranging for large amounts to be paid into their pension schemes before an expected April 2011 cut-off point. To prevent this, the April 2009 Budget announced so-called 'anti-forestalling' provisions which took effect immediately and applied to the 2009/10 and 2010/11 tax years.

- Initially only individuals who had taxable earnings of £150,000 or more in any tax year, or in either of the previous two tax years, would be affected. This earnings limit was then reduced to £130,000.
- Those affected would be subject to a 'special Annual Allowance charge' where their pension input amount exceeded the greater of the special Annual Allowance and their regular pension input amount being made before the 2009 Budget. The special Annual Allowance for an individual was either:
  - £20,000, or
  - in certain circumstances, an amount greater than £20,000 but subject to a maximum of £30,000
- The rate of the 'Special Annual Allowance Charge' was such as to reduce the rate of relief down to the basic rate.

3.9.2 Tapered Annual Allowance

A majority of individuals have the standard AA. However, with effect from 6 April 2016, a tapered AA was introduced for high earners. This change meant that many more individuals will be subject to AA tax charges.

To check whether an individual is subject to the tapered AA, two income tests apply:

- Testing whether the threshold income, which is broadly total taxable income, is greater than £200,000, and
- Testing whether the adjusted income, which is broadly taxable income plus all pension savings, is greater than £260,000.

For those who pass both the above income tests, the AA reduces by £1 for every £2 of income above £260,000, subject to a minimum AA of £10,000. This is known as the tapered Annual Allowance. The table below shows the AA at various adjusted income levels for those who have threshold income above £260,000:

ADJUSTED INCOME	ANNUAL ALLOWANCE FROM 6 APRIL 2024
Not greater than £260,000	£60,000
£270,000	£55,000
£280,000	£50,000
£290,000	£45,000
£300,000	£40,000
£310,000	£35,000
£320,000	£30,000
£330,000	£25,000
£340,000	£20,000
£350,000	£15,000
£360,000 or more	£10,000

For the tax years 2016/17 to 2019/20, the tapered AA applied if an individual's threshold income was above £110,000 and their adjusted income was above £150,000. For these tax years, the minimum tapered AA was £4,000.

For the tax years 2020/21 to 2022/23, the tapered AA applied if an individual's threshold income was above £200,000 and their adjusted income was above £240,000. For these tax years, the minimum tapered AA was £4,000.

With effect from 6 April 2023, the threshold for the adjusted income was increased to £260,000 and the minimum tapered AA was increased to £10,000. There were no changes for 2024/25.

Threshold income, Adjusted income and the Tapered AA

Example 1a

Mike has a taxable income of £200,002. Mike has made no pension savings, although his employer has paid pension savings of £65,000 on his behalf.

Mike's threshold income is £200,002 and his adjusted income is £265,002. From 2024/25, Mike's AA will be £57,499. Assuming that Mike has no carry forward, he will have an AA tax charge on £7,501 of pension savings (£65,000 less £57,499).

If Mike were to make pension contributions of £2, his threshold income would reduce to £200,000 and his AA would therefore be £60,000. He will now only have an AA tax charge on £5,002 of pension savings (£65,002 less £60,000), reducing the amount subject to an AA tax charge by £2,499. So, a £2 pension contribution would reduce his tax bill by around £1,125 (45% of £2,499).

Example 1b

Stuart has a taxable income of £365,000. Currently, his pension savings are £40,000 per annum. His AA will be £10,000 and he will therefore be subject to a tax charge on £30,000 of pension savings. This charge will be £13,500 (45% of £30,000).

3.9.3 Tapered Annual Allowance in Practice

It is not possible for schemes to determine which individuals will be affected by the tapered AA because both Threshold Income and Adjusted Income include income generated from outside of employment. In practice, trustees or employers could not possibly have full details of an individual's other taxable income (such as dividend income, other investment income, any rental income, etc.). Individuals may not know these amounts themselves until after the end of the tax year.

Summary

This Chapter has covered the issue of communication and renewals. This has included best practice as well as the requirements imposed by the disclosure regulations.

Self Test Questions

- Describe the key characteristics of fixed protection, fixed protection 2014 and fixed protection 2016
- What are the key differences between primary and enhanced protection
- Outline the key features of individual protection 2014 and individual protection 2016
- Describe the concept of the tapered Annual Allowance for high earners

Part 5

TREASURY MANAGEMENT

OVERVIEW

This part comprises 3 chapters.

Part 5 looks at the various aspects of treasury management that occupational pension schemes need to consider.

Chapter 1 outlines the operation of a pension scheme bank account. Chapter 2 explains the requirements of scheme accounting and auditing. Finally, Chapter 3 details the operation of pensioner payroll.

CHAPTER 1

OPERATION OF A PENSION SCHEME BANK ACCOUNT

INTRODUCTION

This Chapter outlines bank account requirements and also provides further information on cash management, record keeping and reporting.

1.1 BANK ACCOUNTS

Under the Pensions Act 1995, it is a statutory requirement for trustees of occupational pension schemes to open and maintain a trustee bank account, unless exempt. A bank account is necessary to evidence the separation of employers' and employees' contributions. Therefore, both employees and the employer can make contributions directly to the trustees. This requirement includes any special payments such as transfer values, special contributions by the employer, donations and bequests and any monies that have been made payable to the trustees unless transferred directly to the investment manager.

The bank needs to be formally appointed by the trustees. The trustees would evidence the operation of the account by establishing mandates with the bank covering the authority levels for the drawing or transfer of monies from the account for:

- Payments to beneficiaries
- Transfers out of members' benefits
- Payment of contributions to investment managers
- Payment of expenses

The trustees are required to evidence the granting of authorities within the trustees' minutes. These should be amended when any of the authorised signatories change and following a review of the authorities. A review of the authorities should be carried out annually to ensure that they are still appropriate and current. Normally, it is expected that two signatories would be required to sign an instruction to the bank and that a majority would be required to effect significant transfers of money to other funds or to effect disinvestments from the fund managers. The terms of operation of the bank accounts, including charges, should be recorded in the trustees' appointment letter, which should be reviewed regularly.

Where the administration of a scheme is outsourced to a third-party administrator (TPA), the TPA may be given a requirement to invest the contributions in a timely manner and operate the trustee bank account. The majority of TPAs will operate individual accounts for each client and for separate schemes of those clients. It is uncommon for a TPA to operate a conglomerate account for all of its clients. TPAs can handle multiple accounts for little or no additional costs due to technological advances in banking systems.

Internally, TPAs operate a hierarchy of authorised signatories in the same way that trustees do. TPAs also maintain the cashbook and monitor the payments through the accounts. The need for money to flow swiftly through the current account negates the requirement for money to be held in a deposit account.

1.2 CASH MANAGEMENT

For DB schemes, contributions are pooled and invested for the benefit of the entire membership. For DC schemes, contributions are invested for the benefit of an individual, who has an individual account within the scheme.

Trustees must ensure that there are sufficient funds within the bank account to meet the scheme's day to day expenses and expected benefit payments. The trustee bank account should not run out of funds or incur unnecessary overdraft charges. To avoid this, it is important that future income and expenditure are predicted accurately.

Cash flow projections should be undertaken at least monthly to encompass all anticipated income and expenditure. Whilst the timing of many items can be predicted, such as contributions and administration expenses, others, such as death benefits and transfer payments, are more difficult to predict. A close relationship with insurers and investment managers will greatly assist when making such payments.

If the bank account is interest bearing, the trustees must make a decision on the interest earned from members' contributions. Some DC schemes take a pragmatic approach and use the interest earned to offset any administrative fees or other expenses. However, where trustees feel the interest belongs to members, they may wait until it has accumulated and then allocate it to members as a special contribution.

1.3 TIMING OF CONTRIBUTIONS

Most schemes are 'contributory', which means that members must pay contributions into the scheme if they are to receive any benefits. If the member is employed, then their employer may also contribute to the scheme.

Under the Pensions Act 1995, the trustees of a defined benefit (DB) scheme must draw up a schedule of contributions showing what contributions should be paid to the scheme and when they should be paid. For defined contribution (DC) schemes, the trustees must prepare, maintain and revise from time to time if necessary, a payment schedule showing the contributions payable to the scheme and when they should be paid. The amount to be paid will also be contained in the policy documentation or trust deed and rules of the scheme.

Contributions are usually expressed as either a fixed sum or as a percentage of earnings. If contributions are expressed as a percentage of earnings, the scheme/trustees may need the employer to confirm salaries with them from time to time and the employer will need to be able to readily provide this information.

If contributions are expressed as a percentage of pay, the employer needs to decide which elements of members' pay are pensionable (that is, which elements are used to calculate pension contributions), and this would be set out in the scheme rules. For example, the employer may decide that only a member's basic pay is pensionable and that no pension contributions are deducted from their bonus or overtime payments. The employer will inform the scheme/trustee which elements should be included.

Regulations under the Pensions Act 1995 require that the employer must pay any employee contributions, including any additional voluntary contributions (AVCs), to the trustees by:

- The 22nd of the month following the month in which the contributions are deducted from members' pay, if the contributions are paid electronically, or
- By the 19th of the following month if the contributions are paid by other means.

Failure to pay contributions to the trustee bank account within the above timescales represents a breach of the regulations which, in some cases, may need to be reported to the Pensions Regulator (TPR). A breach would also occur where either a schedule of contributions or payment schedule is in place and the payment date is missed, even if the 19th / 22nd date is met. Trustees must check that both the correct amount of contributions is paid and that they are paid on time. Where, for example, a TPA maintains the bank account, trustees must agree with the TPA how the receipt of contributions will be monitored and who is responsible for ensuring that the correct amount is paid.

1.4 RECORD KEEPING

The Registered Pension Schemes (Provision of Information) Regulations 2006 (as amended) set out the records that must be retained by pension schemes. These records relate to:

- Any monies received by or owing to the scheme
- Any investments or assets held by the scheme
- Any payments made by the scheme
- Any contracts to purchase a lifetime annuity in respect of a member of the scheme
- The administration of the scheme

The regulations impose a requirement on trustees and the sponsoring employer of an occupational scheme or any person providing administrative service to keep the records for six years from the tax year to which they relate.

1.5 RECONCILIATION PROCESSES

Trustees must regularly check that both the correct amount of contributions are paid and that they are paid on time. Where, for example, a TPA maintains the bank account, trustees must agree with the TPA how the receipt of contributions will be monitored and who is responsible for ensuring that the correct amount is paid. This can be done:

- For DB schemes, by comparing the amounts received against the schedule of contributions
- For DC schemes, by comparing the amounts received against the payment schedule

1.6 REPORTING

Failure to pay contributions to the trustee bank account within the above timescales represents a breach of the regulations. The trustees must report to TPR if they have reasonable cause to believe that the employer's failure to pay contributions is likely to be of 'material significance'. Trustees should seek to enquire from the employer:

- the cause and circumstances of the payment failure
- what action has been taken by the employer because of the payment failure, and
- the wider implications or impact of the payment failure, for example on member benefits.

Circumstances which are likely to be material and which the trustees should report include:

- a reasonable cause to believe the employer is not willing to pay the outstanding contributions. Where the trustees' reminder and recovery process has been exhausted without response from the employer or without them having obtained the outstanding payment, the trustees may assume this indicates the employer's unwillingness to pay,
- payment failure involving possible dishonesty or a misuse of assets or contributions,
- a failure to pay contributions which carries a criminal penalty, the trustees becoming aware that the employer does not have adequate procedures or systems in place to ensure the correct and timely payment of contributions due, and the employer appears not to be taking adequate steps to remedy the situation, and
- contributions have been outstanding for 90 days from the due date.

TPR expects trustees to make a report within a reasonable period, which is usually 10 days.

1.7 EVENT REPORT

There are a number of events that scheme administrators must report to HMRC if they occur in a registered pension scheme during a tax year. The event report is used to submit these reportable events for the tax year to which they relate. It is split into two categories:

- Reportable fund movements – these arise when certain payments are made from a pension scheme, such as: unauthorised payments, payment of a serious ill-health lump sum and cessation of an ill-health pension.
- Reportable changes – these arise when there are changes in the details about a registered pension scheme such as: a change in legal structure of the scheme or completion of wind up of a scheme.

The entire list of these events for the 2024/25 tax year is set out in the table below:

REPORTABLE EVENT	DESCRIPTION
1	Unauthorised payments
3	Early provision of benefits
4	Serious ill-health lump sum
5	Cessation of ill-health pension
9	Transfers to qualifying recognised overseas pension schemes
10	Investment-regulated pension scheme
11	Changes in scheme rules
12	Changes to rules of a scheme treated as more than one scheme pre A-day
13	Change in legal structure of scheme
14	Change in number of members
18	Scheme chargeable payment
19	Country or territory of establishment
20	Occupational pension scheme
20A	Master Trust scheme
22	Annual allowance
23	Dual annual allowances
24	Payments of lump sum and lump sum death benefits in excess of the allowances in relation to relevant benefit crystallisation events

The Registered Pension Schemes (Provision of Information) Regulations 2006 and HMRC's Pensions Tax Manual provide further details on the conditions under which a payment should be reported and on what information needs to be provided to HMRC.

The event report must be submitted electronically using Pension Schemes Online, and no later than 31 January after the end of the tax year to which it relates. There are two exceptions to this deadline, and they are:

- Transfers to a qualifying recognised overseas pension scheme must be reported to HMRC within 60 days of the transfer using form APSS 262.
- HMRC must be notified of the date on which the wind up of a scheme is completed within the earlier of three months of completing the wind up or the last day on which an event report is due.

HMRC have powers to levy penalties on scheme administrators who fail to report, or who report late or inaccurate information.

Summary

This Chapter has explained the operation of pension scheme bank accounts and scheme record keeping.

Self Test Questions

- List the records that must be maintained by pension schemes
- Describe the concept of cash management
- Explain the time limits for employers paying contributions into a scheme

CHAPTER 2

SCHEME ACCOUNTING AND AUDITING

INTRODUCTION

This Chapter covers the features and requirements of scheme accounting as well as the audit requirements for pension schemes.

2.1 SCHEME ACCOUNTS

The format and content of pension scheme accounts is governed by the requirements of:

- The Pensions Act 1995
- The Statement of Recommended Practice (SORP)
- General accounting principles

2.1.1 Pensions Act 1995

The trustees' report and accounts need to comply with the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013. The report and accounts will include:

- the names of the trustees during the scheme year
- the provisions of the scheme
- the number of beneficiaries and active, deferred and pensioner members
- for DB schemes, the percentage increases made (on top of legislative requirements) during the year to pensions in payment and deferred pensions, together with a statement clarifying the extent to which any increase was discretionary
- the names of the trustees' professional advisers, bank, custodians and other persons or organisation who have acted or were retained by the trustees during the scheme year, together with any changes since the previous scheme year
- a statement as to whether the accounts have been prepared and audited in accordance with the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996
- details on who has managed the investments of the scheme during the year and the extent of any delegation of this function by the trustees
- a copy of any statement made on the resignation or removal of the auditor or actuary and made in accordance with regulations made under section 47(6) of the 1995 Act (professional advisors).
- for DC schemes, a statement which the trustees are required to prepare in accordance with regulation 23 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

The trustees' report and accounts have to be signed within seven months of the scheme year end. HMRC sends out notices to the trustees of larger occupational schemes to produce audited accounts. The deadline for submission is the later of the date stated in the notice or seven months from the end of the period of account.

Smaller schemes are issued with a notice from HMRC to make a Registered Pension Scheme Return. Notices are issued mainly to small occupational schemes with fewer than 50 members and to non-occupational schemes that are investment-regulated, such as Self Invested Personal Pensions. The Registered Pension Scheme Return will normally have to be filed by 31 January following the tax year to which it relates.

The availability of the report on request has to be communicated as part of the basic information about the scheme sent to members. Copies of the report and accounts must be submitted to those requesting them within two months of the request being made. If the trustees fail to sign their reports and accounts within seven months of the scheme year end to which they relate, they may be liable to sanction and fines by TPR.

The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 require a statement within the audited accounts to the effect that they have been prepared in accordance with the Statement of Recommended Practice (SORP) which applies at the end of the scheme year to which the accounts relate. If not, an indication is required of any material departure from the SORP guidelines.

2.1.2 Statement of Recommended Practice (SORP)

The SORP sets out the formal guidelines relating to financial statements and disclosures and recommends areas that an attaching trustee report should cover.

The SORP covers most pension arrangements including:

- Occupational DB and DC schemes
- Fully insured schemes
- Earmarked schemes
- Employer financed benefit schemes
- Schemes in wind up
- Overseas schemes
- Trust-based stakeholder schemes

It excludes:

- Unfunded schemes
- Group Personal Pensions
- Free standing AVC arrangements
- Non trust-based stakeholder schemes

The original SORP 1, Pension Scheme Accounts, was published in 1986. The current Statement of Recommended Practice (SORP 2018), applicable to the preparation of financial reports of pension schemes is effective for accounting periods commencing on or after 1 January 2019. Where the previous year's accounts have been prepared in accordance with an earlier SORP, the previous year comparative figures should be restated in line with the new SORP. The main changes introduced by SORP 2015 are:

- Amendments to fair value hierarchy disclosures
- Clarification of 5% concentration disclosure notes to include investment holdings in pooled investment vehicles
- Requirement to disclose the legal nature of pooled arrangement and the trustees' approach to managing the direct credit risk.
- Further guidance in relation to common investment funds.

Benefits

Disclosures are required where there are significant benefits pending at the year-end.

Where a member's benefits exceed the Annual Allowance, and a tax charge is payable, the tax can be paid by the scheme on behalf of the member and subsequently deducted from their benefit when paid. The payment can be:

- Expensed in the accounts, on the basis that the cost is paid through the reduced benefit payments
- Recorded in the accounts as a debtor, which is settled by the member when their benefits are paid.

2.1.3 General Accounting Principles

Accountancy has generally shown evolutionary, rather than revolutionary, change. It is generally accepted that four concepts are fundamental, insofar as non-compliance needing to be stated. These are:

- **Going concern –** The enterprise is assumed to be continuing in operation at a similar scale for the foreseeable future
- **Consistency –** There is a consistency of accounting treatment of like items within each accounting period and from one period to the next
- **Accrual –** Revenue and costs are accrued, i.e. recognised for accounting purposes as they are earned or incurred (regardless of when received or paid). This leads to the idea of 'matching' revenues against the costs incurred in earning them
- **Prudence –** This will lead accountants to bias their reports, when faced with incomplete knowledge or uncertainty. They will set aside something for an uncertain liability but will not anticipate an uncertain gain

These accounting concepts have different applications for pension fund accounts:

- **Going concern:**
  - Any clause in a scheme's Trust Deed and Rules enabling the employer to terminate or suspend support for the scheme at short notice is to be ignored. A particular scheme could be closed to further accrual in the future, but it must be assumed to be a going concern. This means the scheme is assumed to continue and is not undergoing a wind-up
- **Consistency:**
  - No particular exceptions for pension schemes.
- **Accrual:**
  - The concept of accrual within a DC scheme is far more simplistic than in a DB arrangement. The matching of revenue and costs is more straightforward because, with the payment of contributions over to the investment manager, the liability ceases and there is no requirement to accrue for future benefit payments
- **Prudence:**
  - Within a DB pension arrangement, the concept of prudence is one of the most debated, i.e. whether assets should be viewed at the lower or upper end of the market value. With a DC scheme, the problems surrounding future liabilities do not exist

2.2 AUDITING AND AUDIT TRAILS

The Pensions Act 1995 requires a scheme's annual accounts to be audited. The Act also sets out the requirements for the appointment of an auditor by the trustees. An auditor of a scheme cannot be the scheme's employer, hold a position as a trustee or administrator to the scheme nor be a member of the scheme.

A formal letter of appointment needs to be drawn up and signed by the trustees and the auditor. This sets out the scope for the audit, the terms of the engagement and the respective responsibilities and duties of the trustees and the auditor. Each appointment must be acknowledged, and the trustees should be notified of any conflict of interest.

On resignation or removal, an auditor must produce a statement detailing any circumstances connected with the resignation or which is believed to 'significantly affect' the interests of scheme members or beneficiaries. The trustees have three months in which to replace an auditor.

Auditors have a duty to inform TPR immediately (i.e. whistle-blow) if there is reasonable cause to believe that there has been a breach of the legislation that is likely to be of material significance to TPR in the exercise of its functions.

An auditor need not be appointed for:

- Unfunded arrangements
- Employer financed benefit schemes
- Occupational schemes with fewer than two members
- Occupational schemes providing only lump sum death benefits
- Certain public sector arrangements
- DC and DB schemes where there are fewer than 12 members and all members are trustees and either all decisions are made by unanimous agreement of the members, or the scheme has an independent trustee who is on the approved list by TPR

While trustees have the responsibility of producing the financial statements, the auditors are charged with the duty of expressing an independent opinion on those statements.

The standard audit opinion, which is contained in the auditor's report to the trustees, confirms that for the period under review, in the auditor's opinion:

- The financial statements give a true and fair view of the financial transactions in the period
- The financial statements give a true and fair view of the disposition of the scheme's assets and liabilities
- The statements contain the information specified in the regulations
- Contributions have been paid in accordance with the Payment schedule (DC schemes) or the Schedule of Contributions (DB schemes), as appropriate, and the scheme rules

The audit is an examination of the books and accounting records kept by (or on behalf of) the scheme in order for the auditors to arrive at an opinion regarding the financial statements. Clearly, for a large scheme it is not possible to check every detail of every transaction and the audit includes a detailed review of a sample of transactions. In selecting what to review, the auditors will use statistical sampling techniques whilst keeping in mind what is likely to be material and the risk to the scheme of a potential misstatement. An audit may extend to a review of administration procedures to ensure that benefits are being calculated in accordance with scheme rules.

Adequate supporting documentation needs to be kept in relation to every financial transaction in order to keep an audit trail. In general terms, an audit trail is the ability to trace the history of a financial transaction from initiation to payment so that if needed, it can be reviewed and checked for accuracy at a later date. For benefit calculations, this means the information on which the calculation is based, for instance, for benefits from a DC fund, the date and prices used to calculate the value of the member's fund. For other payments, there may be an invoice, receipt or other form of authorisation, which provide a clear audit trail.

Summary

This Chapter has provided an overview of pension accounting and auditing.

Self Test Questions

- Explain the accounting concepts for pension funds
- List the types of pension arrangements that SORP covers
- Briefly describe the audit process

CHAPTER 3

PENSIONER PAYROLL

INTRODUCTION

This Chapter describes the pensioner payroll requirements registered pension schemes must adhere to and how the various elements that make up pensioner payroll apply to member benefits.

Pension schemes can decide to either outsource their payroll function to an external provider or run it

in-house. In both cases, the scheme is legally responsible for ensuring all aspects of record keeping, and for completing all pay as you earn (PAYE) tasks.

3.1 SETTING UP A PENSIONER PAYROLL

If a scheme decides to run their payroll function in-house, they will need to complete certain tasks in order to pay their members for the first time. HMRC rules require pensions to be paid at least annually. The scheme rules often set out the frequency of payments to pensioners - for example, payments could be made either weekly or monthly in advance.

The tasks that must be completed are:

- Register as an employer with HMRC and get a login for pay as you earn (PAYE) Online
- Choose your payroll software to record member details, pension amounts, calculate deductions, and report to HMRC
- Collect and keep records
- Tell HMRC about your scheme members, and
- Record pension payments, make deductions and report to HMRC on or before the first payment date and every subsequent payment date thereafter.

3.2 RECORD KEEPING

The trustees or their pension payroll provider must keep payment records of:

- Different elements of pension, when they commenced and how and when they are increased
- Any pension review dates e.g. for ill health, children's pensions or step up pensions (a step up could be required, for example, where a pensioner reaches GMP payment age and the pension in payment needs to be increased to meet the GMP)
- Details of the spouse's/civil partner's benefits
- Member's bank account, address and tax details
- Any continued life-cover payable on early retirement
- The date any guarantee period ends
- The amounts of allowances used up by the member through relevant benefit crystallisation events (RBCE) in the scheme

PAYE tax records must be kept for remitting the correct amounts to HMRC and for providing year end P60 information and P45 details on death. HMRC may check records to make sure the right amount of tax is being paid.

3.3 REAL TIME INFORMATION (RTI)

RTI means trustees of pension schemes must, as part of their payroll process, tell HMRC about PAYE payments at the time they are made, rather than just once a year at payroll year end. PAYE should still be processed in the same way, but pension schemes will need to submit payroll information to HMRC on or before the date any payments are made. The information should be submitted using a Full Payment Submission (FPS). Payroll providers have developed software that generate the required reports that contain the payroll information that needs to be submitted online to HMRC.

If the scheme does not have to make any payment in a particular tax month, there will be no FPS to send to HMRC. The scheme must notify HMRC of this by sending an Employer Payment Summary (EPS) by the 19th of the following tax month.

HMRC will levy a penalty against a pension scheme if:

- the FPS was late (if prior warning notices are ignored)
- they did not send the expected number of FPSs
- they did not send an EPS when the scheme did not pay any members in a tax month – HMRC may also issue the scheme with an estimated PAYE payment demand

The amount of the penalty will depend on the number of members in receipt of payments from the scheme (see table below).

NUMBER OF MEMBERS	MONTHLY PENALTY
1 - 9	£100
3 - 49	£200
50 - 249	£300
250 or more	£400

3.4 APPLICATION OF TAX CODES

A tax code is a reference used to calculate the amount of Income Tax (if any) to deduct from a pensioner's pension. Different rates of tax apply if you live in Scotland.

Tax codes are issued by HMRC to inform pension schemes how much tax-free income a pensioner should receive (i.e. their personal allowance). Any amount in excess of the personal allowance is subject to Income Tax.

Before the start of the tax year, HMRC write to all pensioners informing them of their new tax code for that tax year. Pensioners can also obtain their tax code from either their payslips, or P60 received after the end of each tax year.

The process HMRC use to determine a pensioner's tax code is as follows:

- Calculate all the tax allowances to which the individual is entitled
- Calculate the level of income on which tax has not been paid, and any taxable employment benefits
- The tax code is based on the pensioner's tax allowances, but this is reduced by the income on which the pensioner has not paid tax

Tax codes are made up of numbers which show how much income an individual can have before they pay any tax and a letter which shows the individual's situation and how it affects their tax-free Personal Allowance. The standard personal allowance for the 2024/25 tax year is £12,570.

The table below explains what the various letters mean:

LETTER	WHAT IT MEANS
L	Entitled to the standard tax-free standard personal allowance
M	Marriage allowance and have received a transfer of 10% of their partner's personal allowance
N	Marriage allowance and individual has transferred 10% of their personal allowance to their partner
S	Income or pension is taxed at the Scottish rate of Income Tax
C	Income or pension is taxed at the Welsh rate of Income Tax
T	Tax code includes other calculations to work out the individual's personal allowance
0T	Either the individual's personal allowance has been used up, or they have started a new job and do not have a form P45, or they did not give their new employer the details they need to provide them with a tax code
S0T	For an individual living in Scotland, either their personal allowance has been used up, or they have started a new job and do not have a form P45, or they did not give their new employer the details they need to provide them with a tax code
C0T	For an individual living in Wales, either their personal allowance has been used up, or they have started a new job and do not have a form P45, or they did not give their new employer the details they need to provide them with a tax code
BR	All income from this pension is taxed at the basic rate of 20%. This is usually applied if an individual has got more than one job or pension
SBR	All income from this pension is taxed at the basic rate in Scotland of 20%. This is usually applied if an individual has got more than one job or pension
CBR	All income from this pension is taxed at the basic rate in Wales of 20%. This is usually applied if an individual has got more than one job or pension
D0	All income from this pension is taxed at the higher rate of 40%. This is usually applied if an individual has got more than one job or pension
SD0	All income from this pension is taxed at the intermediate rate in Scotland of 21%. This is usually applied if an individual has got more than one job or pension
CD0	All income from this pension is taxed at the higher rate in Wales of 40%. This is usually applied if an individual has got more than one job or pension
D1	All income from this pension is taxed at the additional rate of 45%. This is usually applied if an individual has got more than one job or pension
SD1	All income from this pension is taxed at the higher rate in Scotland of 42%. This is usually applied if an individual has got more than one job or pension
SD2	All income from this pension is taxed at the advanced rate in Scotland of 45%. This is usually applied if an individual has got more than one job or pension

SD3	All income from this pension is taxed at the top rate in Scotland of 48%. This is usually applied if an individual has got more than one job or pension
CD1	All income from this pension is taxed at the additional rate in Wales of 45%. This is usually applied if an individual has got more than one job or pension
NT	No tax is paid on the individual's pension

When a tax code is a number followed by a letter, the amount of tax-free pay an individual may earn in a year is ten times the number in the tax code. The tax code spreads the tax-free amount equally over the year to make sure the same amount of tax is remitted to HMRC each time the pensioner is paid.

To illustrate how this works, say a pensioner who earns £2,500 per month was issued a tax code of 1257L by HMRC, then:

Personal allowance for the year
(1257 x 10) = £12,570

Monthly tax free allowance
(12,570/12) = £1,048

Monthly taxable income
(£2,500 - £1,048) = £1,452

Monthly Income Tax paid
£1,452 x 20% = £290.40

When a tax code is either made up of two letters or the letter 'D' followed by either the number zero or one, the pensioner will have no tax-free allowance. These tax codes are issued when a pensioner has at least two sources of income and their personal allowance has been applied to their main source of income. The other income to which this tax code will apply will be taxed at the individual's marginal rate.

For example, if the pensioner in the illustration above was issued a basic rate (BR) tax code for another source of income of £1,500 per month then:

Personal allowance for the year
Nil

Monthly taxable "other" income
= £1,500

Monthly Income Tax paid
£1,500 x 20 = £300

When a tax code is issued on either a week 1 or month 1 basis, a proportion of any tax free allowance an individual may have will be applied for each pay period. It means only income earned for that pay period will be assessed, and previous pay and tax in the year will not be taken into account. One of the main reasons why HMRC may issue this type of tax code is to ensure that too much tax is not deducted if a pensioner's personal allowance has been reduced.

When a tax code has a 'K' at the beginning, it means the individual has income that is not being taxed another way and it is worth more than their tax-free allowance. This happens when the individual is:

- Paying tax they owe from a previous tax year through their wages or pension
- Getting benefits they need to pay tax on, for example, State benefits or company benefits

3.5 PENSION INCREASES

Once in payment, pensions are increased according to whether or not the arrangement is contracted out, and according to the legislative requirements, scheme rules and the sponsoring employer's practice.

Since 1 January 2011, statutory increases to pensions in payment have been based on increases in the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI). Each year, the Government publishes the increase order, based on the change in inflation from September to September (the reference period). Statutory minimum pension increases are as follows:

GMPs

- The scheme is not required to provide any increases on GMP earned between 6 April 1978 and 5 April 1988
- The scheme is required to provide increases in line with inflation (CPI) up to a maximum of 3% on GMP for service between 6 April 1988 and 5 April 1997

Excess Elements

- There is no legal requirement to increase any remaining pre-6 April 1997 pension in excess of the GMP (except in certain circumstances where a refund of surplus has been paid to the employer).

Nevertheless, many schemes pay regular increases either on a guaranteed, discretionary, or guaranteed plus discretionary, basis

- Any excess pension which relates to service between 6 April 1997 and 5 April 2005 (except AVC pensions), must increase every year at the lower of 5% or the increase in the CPI for the 12 months ending the preceding September. This basis is referred to as Limited Price Indexation (LPI)
- For pension in respect of service from 6 April 2005, it is possible (but not compulsory) for the trustees to adopt a lower rate of LPI, this being the minimum of 2.5% and the increase in the CPI for the 12 months ending the preceding September

Note that the above are statutory minimum pension increase requirements. It is possible for schemes to provide pension increases in excess of the statutory minimum. For example, some schemes may continue to use RPI as the increase basis and/or apply a different reference period or simply provide fixed increases that are at least as high as the cap applying to LPI.

3.6 DISCLOSURE REGULATIONS

If the method of increasing pensions changes, members must be notified automatically before, or within one month after, the change.

3.7 TAXATION OF LUMP SUMS

3.7.1 Pension Commencement Lump Sum (PCLS)

A PCLS is paid tax free (see Part 3 Chapter 3.7) and the payment is normally not made through pensioner payroll. A separate payment, either through BACS or a cheque, is normally made by the scheme to the member.

3.7.2 Trivial Commutation Lump Sum (TCLS) Options

The table below sets out how the TCLS payment or Small Lump Sum payment is taxed. The amount of tax paid depends on whether it is paid after or before any pension benefits have been brought into payment.

PAID AFTER PENSION HAS COMMENCED	PAID AS THE FIRST AND ONLY PAYMENT FROM THE PENSION SCHEME
Treat the payment the same as earlier pension payments and use the same tax code	Use the basic rate (BR) tax code on a week 1/ month 1 basis
Give the pension recipient a P45 to show the pension has been paid off in full - with both the regular payments and the trivial commutation payment	Give a P45 to the pension recipient
Put the payment date on their payroll record as the date of leaving	Put the payment date on their payroll record as the date of leaving
Complete the relevant fields on your full payment submission (FPS), including the payment type	Set the occupational pension indicator on the FPS and complete the relevant fields, including the payment type

Where the TCLS includes a tax free element (see Part 3 Chapter 3.8), payment of this amount should also be made through pensioner payroll. This will ensure the tax free amount is reported to HMRC.

3.7.3 Uncrystallised Funds Pension Lump Sum (UFPLS) Options

The entire UFPLS amount (tax free and taxable elements) should be paid through pensioner payroll. The table below sets out how the taxable element of the UFPLS payment is taxed. The amount of tax paid depends on whether it is paid after or before any pension benefits have been brought into payment.

PAID AFTER PENSION HAS COMMENCED	PAID AS THE FIRST AND ONLY PAYMENT FROM THE PENSION SCHEME
Treat the payment the same as earlier pension payments and use the same tax code	Use the emergency tax code on a week 1/month 1 basis
Give the pension recipient a P45 to show the pension has been paid off in full - with both the regular payments and the UFPLS payment	Give a P45 to the pension recipient
Put the payment date on their payroll record as the date of leaving	Put the payment date on their payroll record as the date of leaving
Complete the relevant fields on your full payment submission (FPS), including the payment type.	Set the occupational pension indicator on the FPS and complete the relevant fields, including the payment type.

3.7.4 Lump Sum Death Benefits

The payment of lump sum death benefits is governed by the scheme trust deed and rules. In many schemes, the trustees will have discretion as to who should receive the lump sum death benefit. Lump sum death benefits are normally paid tax-free to the beneficiary where a member dies before the age of 75 and it is paid within two years of being first notified of the member's death. Lump sum death benefits are taxable if the member is age 75 or over at date of death.

The table below sets out the various types of lump sum death benefits that can be paid. The amount of tax payable depends on the age of the member at date of death.

TYPE OF DEATH BENEFIT	BEFORE AGE 75	AGE 75 OR OVER
Defined benefits lump sum	Payment is tax-free unless the member has insufficient allowance to make the payment, or it is paid outside the two-year limit	Payment is taxed as income through pay as you earn
Uncrystallised funds lump sum	Payment is tax-free unless the member has insufficient allowance to make the payment, or it is paid outside the two-year limit	Payment is taxed as income through pay as you earn
Pension protection lump sum	Payment is tax-free	Payment is taxed as income through pay as you earn
Trivial commutation lump sum	Payment is taxed as income through pay as you earn	Payment is taxed as income through pay as you earn
Drawdown pension fund lump sum	Payment is tax-free unless it is paid outside the two-year limit	Payment is taxed as income through pay as you earn
Flexi-access drawdown fund lump sum	Payment is tax-free unless it is paid outside the two-year limit	Payment is taxed as income through pay as you earn
Annuity protection lump sum	Payment is tax-free	Payment is taxed as income through pay as you earn
Winding up lump sum	Payment is taxed as income through pay as you earn	Payment is taxed as income through pay as you earn
Charity lump sum	Payment is tax-free	Payment is tax-free
Life cover lump sum	Payment is tax-free	Payment is tax-free

The 45% tax charge, known as the special lump sum deaths benefit charge, will continue to apply to taxable lump sum death benefits where the recipient is, for example, a trust or a company and so does not have a marginal rate of Income Tax.

3.8 TREATMENT OF OVERPAYMENT OR UNDERPAYMENTS

The overpayment (and underpayments) of benefits from occupational pension schemes usually happens as a result of either:

- a mistake, for example, benefits being incorrectly calculated; or
- late notification of a death (see Part 3 Chapter 4.4.2).

Trustees must immediately rectify any underpayments and ensure the right level of benefits is paid. Trustees have a duty to recover any overpayment that has been made to a beneficiary/member as they must act in the best interest of all members of the scheme. Recovering overpayments can often be a difficult process, especially if the beneficiary/member does not want to return the payment. The main ways of recovering overpayments are:

- Receiving a lump sum from the beneficiary/ member
- Recovering the overpaid amount from future pension instalments. The trustees must give sufficient notice before correcting the pension
- Reimbursement by the sponsoring employer under an indemnity in the scheme rules
- If the mistake was by a third party, consider recovering the loss from them

The beneficiary/member may be able to avoid repayment to the scheme if they 'change their position' – that is, they acted in reliance of the overpayment. This means the member/beneficiary must show:

- That it was not possible for them to be aware that a mistake had occurred
- There was a direct link between their decisions or expenditure and the mistake
- Their decisions or expenditure are irreversible
- The scheme may be limited on how far back they can go to reclaim any overpayments from the member; the limitation period is six years. The general rule is that the limitation period on a claim (for example, for recovery of an overpayment) starts running once the trustees:
  - have discovered the mistake; or
  - could with reasonable due diligence have discovered it.

3.9 ACCOUNTING FOR TAX

Under the Finance Act 2004, trustees/scheme administrators must make returns to HM Revenue and Customs in respect of the tax for which the scheme is liable. When a scheme does have a tax liability, the return that must be completed to account for this liability is called the Accounting for Tax (AFT) return.

The tax charges that need to be reported on the AFT return are:

- The short service refund lump sum charge. This is payable when the scheme returns contributions to an individual who was a member of a DB scheme for less than two years, or 30 days for a DC scheme. The tax charge is 20% in respect of the first £20,000 refunded, and 50% in respect of the remainder of the refund over £20,000.
- The special lump sum death benefit charge. This is at the rate of 45%.
- The annual allowance charge where the scheme pays the member's charge.
- The authorised surplus payments charge. A 25% tax charge is payable if the scheme pays surplus scheme funds to its employer
- The de-registration charge. A tax charge of 40% of the value of pension scheme assets is payable if HMRC removes the tax registration of the pension scheme
- Overseas transfer charge. A tax charge of 25% applies on taxable overseas transfers made from 9 March 2017. Taxable overseas transfers should be reported for the quarter they were made.

The AFT return must be completed at the end of each quarter where a payment is due. Trustees/ scheme administrators have up to 45 days at the end of each quarter to submit a return together with the associated tax payment to HMRC via their online service. Failure to submit an AFT return or tax charge payment by its due date may result in the scheme being charged a penalty. The table below summarises the period for each quarter and the deadline for making a submission to HMRC.

PERIOD WHEN TAX ARISES	FILING DATE DEADLINE
1 January to 31 March	15 May
1 April to 30 June	14 August
1 July to 30 September	14 November
1 October to 31 December	14 February

Summary

This Chapter has outlined the requirements of a pensioner payroll.

Self Test Questions

- Describe the process HMRC use to determine a pensioner's tax code
- What payroll records must be kept when a payment is made by a pension scheme?
- List the various types of lump sum death benefits

Part 6

SPECIAL SITUATIONS

OVERVIEW

This part comprises 3 chapters.

Part 6 looks at certain special issues occupational pension schemes may need to consider. These include winding-up a trust-based occupational pension scheme, GMP reconciliation, combatting pension scams, and cyber security.

Chapter 1 provides a brief explanation of the issues surrounding internationally mobile employees. Chapter 2 considers the winding up of trust-based arrangements and Chapter 3 provides an update on some current issues.

CHAPTER 1

INTERNATIONALLY MOBILE EMPLOYEES

INTRODUCTION

In this Chapter, we will look at the issues that arise when employees work abroad, whether for short periods or permanently. More and more UK employers now have associate, subsidiary or parent operations outside the UK, so there are increasing numbers of internationally mobile employees. In this Chapter, however, we will only consider the simpler short-term periods of overseas service and permanent overseas residence.

A significant issue for these employees is the tax treatment of their contributions and benefits, which depends on the length of their assignment and whether they remain within the UK scheme.

The implications of the cross border requirements must be considered by employers whenever they have employees working in other European Economic Area (EEA) countries, whether for short periods or permanently. A detailed analysis of these requirements is covered in the specialist option unit of the Advanced Diploma (Managing International Employee Benefits) or Core Unit 1B of the Advanced Diploma (Foundation in International Employee Benefits). However, a brief explanation for awareness is provided in this Chapter.

By the end of this Chapter you should have an understanding of the basic issues that arise when UK employees work or retire abroad.

1.1 SHORT TERM ASSIGNMENTS/ SECONDED EMPLOYEES

These assignments are normally for a short fixed period (usually up to five years) where the employee is expected to return to the UK to work or retire at the end of the period. The employee will usually remain a member of the UK scheme in these circumstances, provided that the scheme rules permit this.

Tax Treatment

There is no restriction on the amount an overseas individual can contribute to a registered pension scheme, but UK tax relief is only available on any pension contributions made where the individual is a 'relevant UK individual' for the tax year in which the contribution is paid.

An individual is a 'relevant UK individual' for a tax year if they meet any of the following conditions:

- They have 'relevant UK earnings' chargeable to Income Tax for that tax year
- They are resident in the UK at some time during that tax year
- They were resident in the UK at some time during the five tax years immediately before the tax year in question and they were also resident in the UK when they joined the pension scheme
- They have, or their spouse or civil partner has, general earnings from overseas Crown employment subject to UK tax for that tax year

'Relevant UK earnings' means any of the following:

- Employment income
- Patent income
- Income which is chargeable under Part 2 or 3 of the Income Tax (Trading and Other Income) Act 2005 and is immediately derived from the carrying on or exercise of a trade, profession or vocation or the carrying on of a UK or EEA furnished holiday lettings business (whether individually or as a partner acting personally in a partnership)
- benefits in kind which are taxable (applies to employees earning over £8,500, and to directors)
- Permanent Health Insurance (PHI) payments paid by the employer whilst you are still in employment
- profit related pay (including the part which is not taxable)

The annual limit for contributions eligible for tax relief is the greater of the individual's relevant UK earnings or £3,600. This means that if an individual is a relevant UK individual but has no relevant UK earnings, relief from UK Income Tax is only available on contributions up to £3,600 for the 2024/25 tax year.

Where relevant UK earnings are not taxable in the UK because of a 'Double Taxation Agreement between the UK and the country of residence, those earnings are not regarded as chargeable to Income Tax and so do not count towards the annual limit for relief.

Relevant UK individuals are subject to the:

- Annual Allowance (AA),
- Individual Lump Sum Allowance (ILSA), and
- Individual Lump Sum and Death Benefit Allowance (ILSDBA) (see Part 4).

1.2 EMPLOYEES WHO TRANSFER ABROAD PERMANENTLY

Where an employee transfers abroad they will usually join a scheme based in their new home country but individuals who are not resident in the UK can remain (or become) members of a UK registered pension scheme.

Whilst the individual is abroad, they can continue to make contributions to and accrue benefits within a registered pension scheme, but they will not be entitled to UK tax relief on those contributions, except under specific circumstances.

The individual concerned must fall within the definition of a 'relevant overseas individual' (see below).

Tax Treatment

A 'relevant overseas individual' is defined by HMRC as an individual who either:

- Is not a relevant UK individual under section 189 Finance Act 2004 – meaning they do not meet the definition in Pensions Tax Manual 044100; or
- Is a relevant UK individual in only the following specified circumstance:
    i. they are only a relevant UK individual because of the five-year rule in section 189(1)(c) Finance Act 2004, that is the third bullet point in the definition of a relevant UK individual linked above, and
    ii. they are not employed by a UK tax resident employer.

An individual who falls into this specified category will be eligible for UK tax relief on member contributions up to £3,600, for up to five years' overseas service, if they are a member of a registered pension scheme that operates relief at source. But if they are working abroad for an overseas tax resident company its (employer) contributions will not attract UK tax relief.

A member of a registered pension scheme who is no longer resident in the UK can be treated as a relevant UK individual in specified circumstances for a tax year if they:

- Were resident in the UK at some time during the five tax years before that year and when they became a member of the pension scheme, and
- Are not employed by a UK tax resident employer.

An employee who ceased to be resident in the UK more than five tax years ago will therefore cease to be eligible for tax relief.

1.3 TRANSFERRING ACCRUED BENEFITS OVERSEAS

An overseas pension transfer is broadly similar to a transfer to another UK registered pension scheme with the additional requirements that the overseas arrangement is a Qualifying Recognised Overseas Pension Scheme (QROPS). Prior to 6 April 2024, a Lifetime Allowance (LTA) test would have taken place at the point of transfer. From 6 April 2024, a test against the individual's available Overseas Transfer Allowance (OTA) must be done prior to the transfer If the transfer includes contracted out benefits, there are further requirements which must be satisfied. In addition, the red and amber flag checks must be carried out as detailed in Chapter 3, Section 3.3.2.

1.4 TRANSFERRING ACCRUED BENEFITS INTO THE UK

Transfers of pension benefits into the UK from overseas are broadly similar to transfers from other UK registered pension schemes.

1.5 OVERSEAS PENSIONERS

Many schemes have members or pensioners who are resident abroad. For such members several issues arise, such as which country's social security system the member belongs to and in which currency should the pension be paid. As the majority of pensions are paid through the automated banking system, trustees may insist that the overseas pensioner maintains a UK bank account into which the pension can be paid in sterling. Otherwise, the trustees could have to convert payments into the currency of the country where the pensioner is resident and the associated commission costs may or may not be deductible from the member's pension, depending upon the rules of the scheme.

Tax Treatment

When an individual resident overseas retires, and where the individual chooses the option of a relevant lump sum, the scheme will need to provide the member with a statement of the ILSA and ILSDBA that has been used up under the scheme, within three months of the relevant benefit crystallisation (RBCE) and once every tax year thereafter. If the individual resident overseas has used up all their ILSA and/or ILSADBA and still wishes to take the lump sum option, the Scheme Administrator will also need to provide details of the pension commencement excess lump sum amount, how it was calculated, what the tax charge was and whether it has been paid.

In most cases, payment of pensions to a foreign country is permitted and Double Taxation Agreements (DTAs) ensure that pensions are not taxed twice. There are DTAs between most industrialised countries covering salaries, dividends, royalties and other payments including pensions. In most cases, but not all, the pension is paid gross from the country where the scheme is located and is taxable in the country where it is received.

1.6 CROSS BORDER PROVISIONS

If a UK based occupational pension scheme has any members who are located in other EEA countries and their employer contributes to the scheme, the implications of the cross border provisions must be considered. These requirements were introduced by the Pensions Act 2004 to ensure that the UK complies with the EU Directive on Institutions for Occupational Retirement Provision 2003/41. The legislation:

- Allows employers to use a UK scheme to cover EEA based employees
- Defines cross-border activity in terms of the acceptance of contributions in respect of members working in an EEA country outside the UK (other than those exempted as 'seconded workers')
- Requires UK schemes operating cross border to be fully funded at all times, and
- Requires UK schemes to comply with host country social and labour law relevant to occupational pensions, in respect of members in the host country. The host country is the EEA state in which the member works

From 1 January 2021, the UK stopped being a member of the EU Single Market or Customs Union.

Most of the EU laws that applied to the UK during the transition period became part of UK domestic law after 1 January 2021, including nearly all of the pension laws that came from EU Directives and

Regulations. These pensions laws have therefore become part of UK law and they continue to apply to UK schemes on that basis.

However, the UK laws that previously governed schemes operating cross-border between the UK and EU/ EEA countries have largely been revoked, meaning that the previous cross-border legal regime that operated until the end of the transition period has changed significantly. This change will impact occupational pension schemes that were previously authorised and approved to carry out EU/EEA cross-border activity.

Where relevant, trustees should also check the guidance issued by other countries outside the UK, including EU/EEA member states.

Summary

This Chapter has outlined some of the issues that surround pensions for internationally mobile employees.

Self Test Questions

- Outline the tax treatment of overseas pensioners
- Write a short note on the cross border provisions
- Explain the tax treatment of a relevant overseas individual

CHAPTER 2

WINDING UP TRUST-BASED WORKPLACE PENSION SCHEMES

INTRODUCTION

The winding up of an occupational pension scheme normally occurs when the company decides it no longer wishes to make the required level of contribution to the scheme (for example, on the grounds of cost), the membership of the scheme is too small to justify the costs of running the scheme, or the company is no longer able to do so (for example, on insolvency).

The continuing increase in the cost of providing DB pensions is another reason that the employer may choose to wind up a DB scheme. Often the first indication that the employer is seeking to limit its liabilities is a closure to new members; a further step is closure to future accrual for existing members.

However, employers cannot just walk away from the promises they have made in a DB scheme. For a solvent employer to wind up the scheme, the assets of the scheme must be sufficient to allow the trustees to buyout the accrued benefits in full with an insurance company. To the extent that the assets do not cover the expected cost of buyout, a statutory debt is served on the employer of the amount required to bring the assets up to that level.

A date is set (often referred to as the wind up date) after which any active members would cease pensionable service and no longer contribute to the scheme. The scheme rules may sometimes dictate that a period of notice has to be given to members of the wind up date. Employers would need to consult with affected employees before they decided to close the scheme and wind it up.

The scheme rules will have provisions dealing with the winding up of the scheme and the way that any assets should be distributed.

2.1 COMPANY INSOLVENCY

If an employer becomes insolvent, it is likely that an insolvency practitioner will be appointed to act in place of the employer.

The existing trustees may continue in place and it is their responsibility to wind up the scheme in accordance with the scheme rules.

As occupational pension schemes are set up under trust, their assets are protected from an employer's creditors. However, a trust cannot protect the value of any investments that the scheme may have invested in the employer's business, and for that reason there are restrictions on the level of employer related investments a scheme can hold.

It may be possible for the receiver or liquidator of a company to claim from the State redundancy fund any contributions that were not paid in the last 12 months of the company's existence. To do this, certain checks have to be made and certificates provided.

Trustees will serve a debt on the employer to bring the schemes assets up to the level required to buyout all benefits in full with an insurer. However, as the pension scheme is treated as an unsecured creditor of the employer, in many cases this debt is not paid in full.

The Pension Protection Fund has been set up to provide some protection to members when a sponsoring employer of a defined benefit pension scheme goes insolvent and the scheme does not have enough assets to buyout PPF compensation with an insurer. This is covered in 2.8.

2.2 INFORMATION DURING THE WINDING UP PERIOD

When a scheme is being wound up, the trustees must issue a notice in writing to inform all members and beneficiaries within one month of the winding up having commenced.

In addition, this notice must:

- Give the reasons the scheme is being wound up
- Give a statement to active members on whether death benefits will continue to be provided
- Inform members whether an independent trustee has been appointed (generally only relevant for defined benefit schemes)
- Supply a name and address for further enquiries

The trustees also need to issue a progress report to members at least every 12 months thereafter. These subsequent reports must give details of:

- Action being taken to recover any assets not immediately available
- The estimated date when final details of members' benefits are likely to be known, and
- The extent (if any) to which the value of the member's benefits is likely to be reduced (unlikely to be relevant for DC schemes)

2.3 THE WINDING UP PROCESS

The winding up of an occupational pension scheme is a very lengthy process and can take a number of years to complete. Most scheme wind ups take at least 18 months, and it has been known for them to take in excess of ten years (particularly for DB schemes).

TPR has published guidance to help trustees of occupational pension schemes meet expectations that the key wind up activities should be completed within two years of the winding up date. The guidance provides suggestions for good practice on administration, planning a scheme wind up and buying out annuities for DB, DC and hybrid schemes.

The key activities that a DB scheme should complete within the two-year period are:

- Calculating whether there is a section 75 debt on the employer (where the assets of the scheme were not sufficient to buy out full accrued benefits with an insurance company), and if so, serving that debt
- Obtaining terms from insurers to secure benefits for pensioners and non-pensioners
- Allocating available assets to members in accordance with the statutory priority order
- Issuing option letters to non-pensioners
- Paying benefits in accordance with options exercised
- Securing benefits
- Providing details of the benefits that have been secured with an insurer
- Conducting a final actuarial valuation
- Obtaining final audited accounts

The key activities that a DC scheme should complete within the two-year period are:

- Receipt or recovery of all member/employer contributions due from the employer
- Establishing that all pensioner members have annuity policies set up in their own name providing the correct scheme benefits
- Production and sign off of final accounts accounting for and reconciling all assets/cash held in trustee bank accounts and investment manager/provider accounts
- Establishing that all other beneficiaries have been identified, fund values determined, secured and statements issued
- Providing options to members

2.4 DATA CLEANSING

The first part of the winding up process normally consists of the trustees checking the accuracy of the scheme data. They must also ensure they have not overlooked anyone who is (or will be) entitled to benefits from the scheme. With TPR's focus on scheme data, and ICO's focus on data protection, this process is improving.

The trustees will need to trace any members who they do not hold a current address for or have received post returned for the member. Tracing can be done using the Department of Work and Pensions tracing service or a specialist tracing agency.

As part of the winding up process, the trustees should advertise in a local paper and the London Gazette to seek any missing beneficiaries. It is important to find all members and locate any other beneficiaries as part of the wind up process.

In addition, a specification of benefits for buyout/ Pension Protection Fund (PPF) purposes must be agreed with the trustees.

If there is any missing data, the administrator can request this from the company or insolvency practitioner. At the same time, notification of leaving forms would be obtained for all active members of the scheme, together with details of any members who continue in the employ of the insolvency practitioner. Records must be checked to ensure that full details of all members' addresses and benefit entitlements are held.

2.5 CONTRACTED OUT LIABILITIES

Before benefits are secured with an insurer, it will be necessary to have completed the GMP Reconciliation process.

The trustees will also need to adjust members' benefit entitlements to take account of any inequalities in the level of the GMP between males and females. If the scheme will be transferring into the PPF, the PPF require trustees to carry out such an equalisation exercise before the scheme transfers. If benefits are being bought out with an insurance company, it is likely that they will also require the trustees to carry out such an equalisation exercise before the buyout can be completed.

2.6 DISCHARGING DUTIES ON TERMINATION

This section is relevant for schemes that are not admitted to the PPF. It is not relevant to schemes that go into the PPF.

The trustees are responsible for using the assets of the scheme to discharge its liabilities.

The trustees obtain quotes from insurers to determine how much it would cost to buy an annuity for members of a defined benefit scheme who are in receipt of a pension.

For members who are not in yet in receipt of benefits the trustees may offer the members a transfer of their funds or, alternatively, buy a deferred annuity on the member's behalf.

For members who have less than two years' service, they may be able to take a refund of their contributions to the scheme.

If the benefit value is lower than a limit set by the Government each year, the member may be able to take a 'winding-up' lump sum. The winding up lump sum limit is currently £18,000.

If the benefits are being bought out with an insurer, once a satisfactory quotation has been obtained and the trustees' written instructions received, the purchase price will be paid over to the insurer together with a completed proposal form, benefit schedule and full data. The wind up can be finalised, and a written statement sent to all members informing them of their benefits and asking them to check their policy when received from the insurer.

TPR's guidance on this area, and other resources to help trustees with winding up, is available at:

http://www.thepensionsregulator.gov.uk/guidance/guidance-winding-up.aspx

2.7 WINDING UP THE SCHEME

A final set of accounts will be produced to demonstrate that there are no assets or liabilities remaining. A Deed of a Termination is then produced and the scheme is formally wound up.

The trustees must also report to HMRC (via the Event report) and TPR (via Exchange) that the wind up has been completed.

2.8 PENSION PROTECTION FUND (PPF)

2.8.1 Eligibility

The PPF came into effect from 6 April 2005. The PPF applies to defined benefit and hybrid schemes (defined contribution schemes are not eligible).

Where a qualifying insolvency event occurs (essentially either receivership or insolvency of the sponsoring employer) and the assets of the scheme are not sufficient to fully buy out the PPF compensation otherwise payable by the PPF with an insurance company, then the scheme providing all other eligibility conditions are met 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 which started winding up before 6 April 2005 are not covered (the Financial Assistance Scheme was established to provide some assistance to members of those schemes). However, schemes where the sponsoring employer became subject to an insolvency event before that date may still be eligible if a further insolvency event occurs.

2.8.2 PPF Compensation

Once a scheme is transferred to the PPF, its assets and liabilities will be transferred to the fund, which will provide PPF compensation. The level of compensation depends on the position of the member at the point the employer went insolvent.

- Members over Normal Pension Age or in receipt of an ill health or survivor's pension received 100% of the pension payable at that time.
- For others, the compensation was 90% of accrued benefits and was subject to an overall cap, which depended on the member's age at date of commencement of benefits and the length of pensionable service, with a long service compensation cap introduced from 6 April 2017 where pensionable service was greater than 20 years.
  - For pensionable service of 20 years or less, then for the year commencing 1 April 2024 the maximum level of compensation was £37,315 p.a. for benefits commencing at 65, and £31,275 p.a. for benefits commencing at age 60. For this purpose, benefits comprised of pension and the pension equivalent of any separate cash sum.
  - For pensionable service of 21 years or more, the compensation cap was increased by 3% per complete year of pensionable service above 20 years, up to a maximum of double the standard compensation cap.
- Pensions also receive LPI indexation, capped at 2.5%, on benefits attributable to service after 5 April 1997, and a spouse's benefit on death.
- In July 2021 the Court of Appeal ruled the PPF compensation cap was unlawful on the grounds of age discrimination. They supported the PPF's approach to increasing payments to PPF and FAS members following the 2018 European Court of Justice judgment in the Hampshire case.
- The PPF's general approach is to offer the option of a lump sum plus interest to those members who received less than 50% of the actuarial value of their original scheme benefits due to being affected by the long service compensation cap. These members will receive an increase to their level of PPF benefits until the actuarial value of their PPF benefits equals 50 per cent of the actuarial value of their original scheme benefits. This may mean that a member will initially receive more than 50 per cent of the pension they would have received from their scheme, because the PPF will take into account the differences between their scheme and PPF level of indexation and revaluation.
- The PPF has decided to not put a time limit for making a legal claim for arrears as a result of the European Court of Justice ruling.

2.9 HYBRID SCHEMES

For hybrid schemes, the PPF regulations set out the procedure for discharging defined contribution benefits within schemes that are eligible for the PPF.

2.10 THE PPF LEVY

The main funding of the PPF comes from levies collected annually on eligible schemes. From 6 April 2006 the levy, which is subject to an overall ceiling each year, comprises a risk-based element and a scheme based element - for the first year of the PPF the levy was set based only on scheme factors. 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, the investment risk inherent in the investment strategy 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.

2.11 FINANCIAL ASSISTANCE SCHEME

The Financial Assistance Scheme (FAS) was set up under provisions made in the Pensions Act 2004. The purpose of the FAS is similar to that of the PPF, i.e. to assist members who have lost pension rights because their pension scheme wound up without sufficient funds to meet the pension liabilities.

The scheme was managed by the Department for Work and Pensions and administered by the FAS Operational Unit. Responsibility has now been passed to the Board of the PPF. It makes payments to top up scheme benefits to eligible members of schemes that are winding up or have wound up.

Eligibility

To be eligible:

- The scheme must have started to wind up between 1 January 1997 and 5 April 2005 (the PPF covers schemes that started wind up after 5 April 2005), and
- Originally the requirement was that the employer must be insolvent or no longer exist, or a 'compromise agreement' has been reached with the employer to prevent employer insolvency. However, the eligibility conditions have since been widened to include underfunded schemes where there was no employer debt at the time wind up commenced

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

Benefits

The benefits (called assistance) now given by the FAS have been improved over those awarded when the scheme was established. They are now similar to the compensation provided by the PPF: Eligible members' pensions will be topped up to 90 per cent of their accrued pension subject to a cap. This will be normally payable from normal retirement age. A member can apply for payment earlier on the grounds of ill health but not before 60, 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 in payment in line with inflation (capped at 2.5% p.a.).

The FAS cap wasn't affected by the ruling on the PPF compensation cap explained in 2.8.2, but some FAS members are entitled to an increase to make sure that they receive 50 per cent of the value of their accrued old age benefits.

FAS closed to new applications from schemes from 1 September 2016.

Summary

If a scheme winds up, all membership records must be fully updated and reconciled to enable members' entitlements to be determined. Where there is a solvent employer, the members' benefits in most cases are bought out with an insurance company. If the scheme's employer is insolvent, the PPF may take over responsibility for paying the scheme's benefits. Once the scheme is wound up, it must be reported to both HMRC and the Pensions Regulator.

Self Test Questions

- Explain the main eligibility requirements for the PPF
- Distinguish between the PPF and the Financial Assistance Scheme
- List the key activities both a DB and DC scheme should complete within the two-year period of the commencement of winding up

CHAPTER 3

CURRENT ISSUES

INTRODUCTION

This Chapter covers some of the current issues facing those running pensions schemes. It includes a brief summary of the guidance guarantee, combatting pension scams and recent legislative and budget related developments.

3.1 GUIDANCE GUARANTEE

Since 6 April 2015, individuals aged 55 or over have been able to access their defined contribution (DC) pension savings in several ways:

- Leave the pot untouched
- Get a guaranteed income (annuity)
- Get an adjustable income
- Take cash out in chunks
- Take whole pot in one go
- Mix the above options

The Government recognised that individuals would need help navigating their way around these options. To help them make sense of it and to be able to take informed decisions, the government introduced a guarantee that all individuals with DC pension savings would be offered free impartial guidance as they approach retirement. The guidance was initially made available to those approaching 55 years old, but the service has since been expanded and is now available from age 50.

The guidance service known as Pension Wise was set up to be delivered by the Citizens Advice Bureau (face to face) and by The Pensions Advisory Service (phone) and typically lasts between 40 minutes and an hour. The service is now maintained by MoneyHelper, which is backed by the Government. The Financial Conduct Authority (FCA) has published standards for guidance providers and is responsible for monitoring compliance. Pension Wise can be found online at https://www.moneyhelper.org.uk/en/pensions-and-retirement/pension-wise.

The guidance covers the individual's range of options to help them make sound decisions and equip them to take action, whether that is seeking advice or purchasing a product.

The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations were amended with effect from 6 April 2015 to set out the requirements for trustees to signpost members to the guidance. The Pensions Regulator issued guidance in April 2015, 'An essential guide to communicating with members about pension flexibilities'.

Firms regulated by the FCA are also required to include a clear and prominent statement about guidance in communications to customers about retirement, and to recommend that they seek guidance or advice. They must also provide appropriate 'risk warnings' to customers who have decided to access their DC pension savings on an 'execution only basis' (that is, where they have decided not to receive advice at that time). Trust-based DC schemes are required to give generic risk warnings.

3.2 COMBATTING PENSION SCAMS

Pension scams are on the increase, with scammers now targeting those wanting to access their DC pension savings as well as those seeking to liberate defined benefit pensions. Scammers use a range of tactics to tempt members to invest their pension savings with them, including directing them to transfer into small (often one or two member) occupational schemes to avoid scrutiny from regulators.

The pensions industry called for guidance to help share good practice and help reduce the risk of successful scams. An Industry Group, Pension Scams Industry Group, was formed to develop a Code of Good Practice on Combatting Pension Scams for use by all in the industry. The latest version (2.2) of the Code applies from 1 April 2021 and applies to all transfer requests processed on or after that date. The main changes to the Code from the previous version (2.1) are:

- An update on both TPR's and the FCA's initiatives to tackle pension scams
- Revised Action Fraud reporting guidance
- TPR/FCA ScamSmart campaign and TPR Threat Assessment update
- Additional Determinations from The Pension Ombudsman (TPO)
- The rise of claims management firms
- Recent legal developments both in the UK and overseas
- Additional case studies

The Code will be reviewed and updated on a regular basis to ensure it reflects current risks and good practice.

It is a voluntary code and sets an industry standard for dealing with transfers from a UK registered pension scheme to another registered pension scheme or Qualifying Recognised Overseas Pension Scheme (QROPS). It does not replace or over-ride existing requirements and/or guidance issued by regulatory bodies on transfers and pension scams.

It is based on three principles:

- **Raising Awareness (Principle 1)** - Trustees, providers and administrators should raise awareness of pension scams amongst members and beneficiaries of their scheme
- **The assessment process (Principle 2)** - Trustees, providers and administrators should have robust, but proportionate, processes for assessing whether a receiving scheme may be operating as part of a pension scam, and for responding to that risk
- **Awareness of current scam strategies (Principle 3)** - Trustees, providers and administrators should generally be aware of the known current strategies of the perpetrators of pension scams in order to inform the due diligence they need to undertake and refer to the warning flags as indicated in TPR's Guidance, FCA alerts and Action Fraud

The Code says that the level of further due diligence is dependent on the type of receiving scheme, for example, occupational pension schemes, self-Invested personal pension schemes etc. The Code provides sample questions for the different types of scheme.

TPR's website sets out how trustees can help members protect their pension savings. It states that trustees should give scheme members regular, clear information about how to spot a scam. TPR and the Financial Conduct Authority (FCA) have also provided materials to help trustees to do this, including a scam smart guide and online warning tool for members to use to check whether an investment or pension opportunity could be a scam.

The scam smart guide sets out four steps for members to protect themselves from pension scams:

- Reject unexpected offers
- Check who you're dealing with
- Don't be rushed or pressured
- Get impartial advice information and advice (for example, the MoneyHelper Service)

3.3 OTHER CURRENT ISSUES

3.3.1 Abolition of the Lifetime Allowance

The Finance Act 2024 (the Act) abolished the LTA with effect from 6 April 2024. The Act also set out the new pensions tax framework.

For most members, the main change concerns how to measure:

- Certain tax-free lump sums against a fixed monetary capped amount called the Lump Sum Allowance (LSA). The capped amount is set at £268,275.
- Certain lump sum death benefits, tax-free lump sums under the LSA and serious ill-health lump sums that are paid tax-free against a fixed monetary capped amount called the Lump Sum and Death Benefit Allowance. The capped amount is £1.0731M.

This will only affect a small group of individuals who have exceptionally large benefits.

Part 4 of the Study Manual provides further details.

3.3.2 New Transfer Regulations

The Department of Work and Pensions (DWP) published The Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021. The regulations set out the conditions that must be satisfied before a statutory pension transfer can take place. The regulations, which came into effect on 30 November 2021, give trustees the power to refuse a transfer where there is a risk that it's part of a pension scam.

Trustees are now required to carry out specific checks before they process a member's statutory request to transfer their pension savings to another pension arrangement. The checks require trustees to be satisfied that either one of two conditions set out in the regulations have been met. The two conditions are:

- The First Condition is met if the receiving scheme is of a type listed in the transfer regulations. To satisfy this condition, the receiving scheme must be one of the following:
  - A public service pension scheme
  - An authorised master trust listed by The Pensions Regulator (TPR)
  - An authorised Collective Defined Contribution (CDC) scheme included on a list to be published by TPR
- The Second Condition applies to transfers into all other receiving schemes. For the second condition to be met, trustees must consider additional scam risk indicators by carrying out certain checks. These checks include:
  - whether there is an employment link if the transfer is to either an occupational pension scheme or a QROPS
  - whether there is a residency link if the transfer is to a QROPS
  - for the presence of red and amber flags.

The table below sets out the red and amber flags when assessing if they are present:

FLAG NUMBER	RED FLAGS	AMBER FLAGS
1	The member has failed to provide the required information	The member has not demonstrated an employment link or residency link
2	The member has not provided evidence of receiving MoneyHelper guidance	The evidence may not be genuine or may not have been provided directly by the member
3	There is evidence that someone has carried out a regulated activity without the required regulatory status	The member cannot demonstrate an employment link or residency link
4	The member requested a transfer following unsolicited contact	High-risk or unregulated investments are included in the scheme
5	The member has been offered an incentive to make the transfer	The scheme charges are unclear or high
6	The member has been pressurised to make the transfer	The scheme's investment structure is unclear, complex or unorthodox
7		Overseas investments are included in the scheme
8		A sharp, unusual rise in transfers involving the same scheme or adviser.

If a scheme determines one or more amber flags are present, they must direct members to MoneyHelper to obtain guidance before the transfer can proceed. If the member still wishes to proceed with the transfer after receiving guidance from MoneyHelper, trustees should record the decision of the member and arrange to pay the transfer.

If a scheme determines one or more red flags are present, they must refuse the transfer and notify the member of their decision within seven working days of their decision.

3.3.3 GMP Equalisation

The key principle of equalisation is that any two people with identical pensionable service and salary will be entitled to the same benefits, whether they are a man or a woman. The equalisation requirement, driven from what is known as the "Barber judgment", has applied since 17 May 1990. Following this, schemes "equalised" their retirement ages.

However, many pension schemes were historically contracted out of the State Earnings Related Pension Scheme (SERPS), resulting in a GMP benefit being payable. GMP mirrors SERPS and is unequal. Over time this creates inequality in scheme benefits.

After years of uncertainty over whether schemes had to address this inequality, a judgment made in October 2018, in the Lloyds Banking Group case, made it clear they did.

However, the judgment did not set out one way of achieving equality. A number of different methods are possible, and trustees having taken legal advice, will need to decide which one is appropriate for their scheme.

For all methods, the scheme administrator needs to calculate the benefits payable in respect of the period 17 May 1990 to 5 April 1997, for both the member and also had the member been of the opposite sex (the comparator), but with the same pensionable salary, pensionable service history, etc.

The different methods can be grouped as follows:

Year on year approach:

Pay the higher of the benefit payable to the member and comparator. This is known as Method B.

Running total:

In addition to determining the year on year, keep track of the running total of payments payable to the member and comparator and pay the amount required to match the higher. This is known as Method C1, and if interest is allowed for on the running total, Method C2.

For pensioners, trustees will need to decide which year on year approach to use to correct past underpayments.

Of the three methods, Method C2 will result in the lowest uplift to benefits and hence trustees can use this without requiring the consent of the employer.

Actuarial equivalence:

For future benefits, another option is to use GMP conversion. This involves converting GMP, which effectively removes all the rules relating to GMP from the scheme, and at the same time equalising the benefits on an actuarial equivalence basis. This method, known as D2, removes the need to maintain dual records.

Carrying out a GMP equalisation project is a complex exercise. For example, in theory, for pensioners it will be necessary to:

- go back to the point the member left contracted out service,
- establish the comparator record at that point,
- work out the benefits that would have been payable to the comparator, and
- then apply the chosen method of GMP equalisation to determine whether a top up is payable.

In many cases, schemes will not have the data to do this accurately and will need to take a more approximate approach and/or make assumptions.

The Pensions Regulator established an industry working group under Pensions Administration Standards Association (PASA) to produce good practice industry guidance to support schemes in preparing for and then implementing GMP equalisation and potentially, for some schemes, conversion. To date, PASA's GMP Equalisation Working Group has issued guidance on:

- When to Rectify
- Data
- Method
- Communication to members

Guidance is also expected to cover taxation issues and past transactions.

3.3.4 Pensions Dashboard

Pension schemes will need to connect to the pensions dashboard and provide data. Pensions dashboard only applies to 'relevant members', which means either active or deferred members.

Previously, the Department for Work and Pensions (DWP) had set out a staging schedule for pension providers and schemes that will provide data to dashboards. The Pensions Dashboard programme has seen several delays since the project started due to its complex nature.

Eventually all UK-based pensions must connect to the pensions dashboards, including:

- Defined Benefit pensions (including cash balance schemes)
- Defined Contribution pensions

The DWP has confirmed a connection deadline of 31 October 2026 for all schemes that fall under the current regulations. Alongside this, they have issued revised connection guidance. Trustees need to consider these dates when connecting their schemes to avoid enforcement action.

There has been a change to the date on which the number of relevant members was determined under the regulations. This is now the number of active and deferred members in the scheme at the scheme year end falling between 1 April 2023 and 31 March 2024. The number of relevant members determines the new connection guidance date and can be obtained from the most recent scheme return.

However, if the scheme has fewer than 100 relevant members, it does not have to connect to pensions dashboards.

Supplying scheme data

Trustees must provide two types of data to the pensions dashboards:

Find data

Find data is the term used for the member contact information and the data used for matching.

Part of the data provided will be used to 'match' members when they search for their benefits on pensions dashboard. The recommended industry standard is to match:

- surname,
- date of birth, and
- National Insurance number.

Deviating from the suggested industry standard match data will result in additional work and cost.

View data

View data is the information a scheme will need to return to a dashboard if a successful match is made to a member record.

View data is split into two categories:

a. ***Administrative data***

This includes:

- Scheme type
- Membership dates
- Relevant information about the employer.

It also includes administration team contact information should the pensions dashboards user have any further queries.

b. ***Value data***

The value data that schemes must supply will depend on whether the scheme is Defined Benefit or Defined Contribution, and whether the member is an active or deferred member of the scheme.

Deferred members of Defined Benefit schemes must receive a statement of their deferred pension revalued to the current year. Trustees may also choose to provide an estimate of the deferred pension at the member's retirement date. Neither of these figures is usually calculated for all deferred members each year.

Active members of Defined Benefit schemes must receive a statement of the pension they have built up in the scheme. They must also receive a statement of the expected pension at their retirement age, assuming no further salary increases. Both figures are usually provided to active members once a year.

Active and deferred members of Defined Contribution schemes must receive a statement of the benefits they have built up and an estimate of what that will be at their retirement date. Schemes already must provide these figures to members in statutory money purchase illustrations.

3.3.5 Pension schemes and climate risk

Pensions are about saving for the long term and over that time horizon, pension schemes will be exposed to risk related to climate change. The risks are grouped into physical risk and transition risk.

Physical risk resulting from climate change can be event-driven (acute) or longer-term shifts (chronic) in climate patterns. Physical risks may have financial implications for organisations, such as direct damage to assets and indirect impacts from supply chain disruption. Organisations' financial performance may also be affected by changes in:

- water availability, sourcing, and quality,
- food security, and
- extreme temperature changes affecting organisations' premises, operations, supply chain, transport needs, and employee safety.

Transitioning to a lower-carbon economy may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change. Depending on the nature, speed, and focus of these changes, transition risks may pose varying levels of financial and reputational risk to organisations.

There will also be opportunities arising from transitioning to a lower carbon economy.

It is increasingly important that these risks and opportunities are understood and taken into account when agreeing investment strategies. From 1 October 2019, the Statement of Investment Principles must now set out how trustees take account of financially material considerations (which may include environmental, social and governance (ESG) factors) over the longer term.

As part of the initiatives on climate change, the UK government has said that all listed companies and large asset owners should prepare disclosures in line with the Task force for Climate risk Financial Disclosures (TCFD). The TCFD framework is designed to help investors understand the climate related risks in their portfolio. To date, some large pension schemes have published these disclosures on a voluntary basis. Disclosures will set out the trustees':

- strategy regarding climate related risks,
- their governance,
- their approach to risk management and
- include targets and metrics which will provide a measure of the scheme's carbon footprint.

3.3.6 Change to Normal Minimum Pension Age

The Finance Act 2022 (FA 2022) increased the normal minimum pension age (NMPA) which is currently 55 to 57 from 6 April 2028. FA 2022 also introduced a new 2028 protected pension age.

The normal minimum pension age (NMPA) is the earliest age at which a member can bring their benefits in a registered pension scheme into payment without incurring penal tax charges.

The concept of a protected pension age was introduced when the NMPA was last increased from 50 to 55 in 2010. It allows a member to retain their previous NMPA where they have an unqualified right (i.e they do not need trustee or employer consent) to bring their scheme benefits into payment. The NMPA is protected even if the benefit is reduced on early payment. It is the lack of a need for consent that makes the minimum pension age protected, not the availability of an unreduced pension.

The increase in NMPA from 55 to 57 will not apply to individuals who:

- Are members of certain public service schemes (for example, firefighters, police or armed forces), or
- Have a 2010 protected pension age, or
- Have a 2028 protected pension age.

Members will qualify for a 2028 protected pension age of 55 (or 56) if:

- They were members of their scheme on or before 4 November 2021, and
- The rules of their scheme on 11 February 2021 included an unqualified right for the member to bring their benefits into payment before age 57.

3.3.7 EU General Data Protection Regulation (GDPR) and UK GDPR

EU GDPR is a European Union Regulation on data protection, which updated existing data protection requirements. It came into effect on 25 May 2018 and was enacted in the UK through the Data Protection Act 2018.

Following Brexit, EU GDPR was replaced in 2021 by almost identical legislation called UK GDPR. This new legislation is simply a copy of GDPR but with references to the EU replaced by references to the UK.

Under both UK and EU GDPR (Data Protection laws), the data controller is responsible for deciding what data is collected and how the data is used; data processors process the data on behalf of the data controllers. For pension schemes the trustees are the data controllers; whilst the scheme administrator is likely to be the main data processor.

Data Protection laws require data controllers to keep detailed records including:

- the name and contact details of the controller
- the purposes of the data processing
- a description of the categories of data subjects and of the categories of personal data
- the categories of recipients to whom the personal data have been or will be disclosed
- where possible, the envisaged time limits for erasure of the different categories of data
- where possible, a general description of the security measures applied

Data controllers must report breaches to the Information Commissioner's Office within 72 hours of occurrence, and the maximum penalty has been increased to the higher of £17.5M or 4% of worldwide annual turnover.

The Government has also said it is committed to maintaining free exchange of data with the EU.

3.3.8 Cyber Security

Technology has provided a number of opportunities for the pensions industry but at the same time it has also increased the risk that pension schemes will become the target of cyber criminals. Cyber risks to pension schemes include:

- hacking attacks against the scheme or a third party administrator
- loss of a laptop containing member data
- virus or malware introduced into the computer system
- scheme administrators falling victim to a phishing email

The Pensions Regulator (TPR) says trustees should capture cyber security as a key risk on their risk registers and review it regularly. This will help trustees put controls in place to ensure the security of member data and meet their obligations under the Data Protection Act 2018. TPR has also published guidance for trustees on cyber security that sets out:

- A cyber risk assessment cycle, to assess risks, identify mitigations and then monitor and report
- Governance requirements
- Possible controls
- How to respond to an incident
- Recognition that cyber risk is a dynamic and evolving risk

The Government, through the National Cyber Security Centre, has published 10 steps to cyber security to help organisations (like pension schemes) protect themselves in cyber space. The 10 steps are:

- **Risk management –** Take a risk-based approach to securing your data and systems..
- **Engagement and training –** Collaboratively build security that works for people in your organisation.
- **Asset management –** Know what data and systems you manage, and what business need they support.
- **Architecture and configuration –** Design, build, maintain and manage systems securely.
- **Vulnerability management –** Keep your systems protected throughout their lifecycle.
- **Identity and access management –** Control who and what can access your systems and data.
- **Data security –** Protect data where it is vulnerable.
- **Logging and monitoring –** Design your systems to be able to detect and investigate incidents.
- **Incident management –** Plan your response to cyber incidents in advance.
- **Supply chain security –** Collaborate with your suppliers and partners.

3.3.8 Stronger Nudge

The DWP published The Occupational and Personal Pension Schemes (Disclosure of Information) (Requirements to Refer Members to Guidance etc.) (Amendment) Regulations 2022. These regulations set out stronger nudge requirements that came into effect from 1 June 2022. However, members can choose to opt out of receiving this guidance, and in some circumstances, may be exempt from these requirements.

The regulations update 'The 2013 Disclosure Regulations' with these new requirements. Trustees must provide a stronger nudge to members who want to access their flexible benefits, recommending appropriate Pension Wise guidance. The stronger nudge is not required for Defined Benefit pensions.

Trustees and managers must:

- Refer members to appropriate pensions guidance and explain its nature and purpose
- Offer to book an appropriate pensions guidance appointment with Pension Wise and, where the member accepts this offer, take reasonable steps to book that appointment. If the member does not accept the offer – or trustees are unable to book an appointment despite having taken reasonable steps
    - trustees must provide the member with details of how to book an appointment
- Explain to members that their application cannot proceed unless they have either received the appropriate guidance and notified the trustees, or opted out of doing so
- Explain to members that they can only opt out of receiving the appropriate pensions guidance by giving the trustees an opt-out notification.

The regulations place record-keeping requirements on trustees and managers. They must keep a record of:

- Confirmation that the member has received appropriate pensions guidance
- Any opt-out notification they receive
- Any applicable exemption they receive.

3.3.9 The Pensions Regulator's Single code of practice

The Pensions Regulator's (TPR) general code of practice has now been laid before Parliament and came into force on 27 March 2024.

The general code has 51 separate modules and consolidates 10 of the existing codes of practice. It also introduces new governance responsibilities for trustees of both Defined Benefit (DB) and Defined Contribution (DC) schemes.

Effective System of Governance

The new code requires trustees to establish and maintain an Effective System of Governance (ESOG). This should be "proportionate to the size, nature, scale and complexity" of the scheme. It should give trustees oversight of the day-to-day operations of the scheme and that the scheme's operations are compliant and correct.

It should include processes and procedures relating to:

- **The trustees' governance policies –** on recruitment and appointment of trustees, meetings and decision-making, remuneration and fees, knowledge and understanding, risk management, conflicts of interest, continuity planning and management of advisers and service providers
- **Investment governance –** including decision making, investment monitoring, stewardship, climate change, and default arrangements and charge restrictions for DC schemes
- **Administration –** including planning and maintenance, contributions and financial transactions, transfers out, scheme data and record-keeping, and maintenance of IT systems and cybersecurity
- **Communication and disclosure to members –** including general principles around communications, statutory communication requirements and pension scams Reporting to TPR, including regular reporting, whistleblowing requirements and reporting on payment failures.

Once the ESOG is established, trustees should set up an appropriate timetable for ongoing review of their governance policies to ensure they're functioning as intended. This should take place at least every three years.

Own Risk Assessment (ORA)

The code introduces a requirement for trustees of schemes with more than 100 members to carry out and document an Own Risk Assessment (ORA) of how well the ESOG is working, and the way potential risks are managed.

Schemes must document their first ORA within 12 months of the end of the first scheme year that begins after the code comes into force. In practice this means 2026 for most schemes. It should then be reviewed at least every three years.

The ORA should also be reviewed when elements of the risk management processes are created or updated, and whenever there is a material change to the ESOG or risks facing the scheme.

The ORA, which must be in writing and signed by the chair, will need to cover:

- How the trustees assessed the effectiveness of their policies and procedures, and the outcome The operation of the trustees' governance policies
- Risk management processes
- Investment and funding
- Administration and payment of benefits.

Other new requirements

The code introduces several other new requirements:

Remuneration policy

Trustees of schemes with 100 or more members should establish a written remuneration policy which must be reviewed at least every three years, covering:

- Activities paid for by the scheme
- Individuals involved in running the scheme or carrying out key functions (including any outsourced providers).

It should also explain the decision-making process around the various levels of remuneration and why they are appropriate.

Policy on appointment of advisers and service providers

Trustees of schemes with 100 or more members should establish a policy covering their approach for the selection, appointment, management, and replacement of their advisers and service providers. This should be reviewed every three years.

Climate change and stewardship

Trustees should consider Environmental, Social and Governance (ESG) matters in their investment decision-making process, and document and maintain processes for identifying and assessing climate change risks and opportunities.

Data and IT

Trustees should implement policies to ensure scheme data is complete, up to date and held securely. They should also assess and manage cyber risks, including service providers' internal controls and cyber security processes, and have suitable policies and controls in place to mitigate cyber risks.

Risk management function

Trustees of schemes with 100 or more members are also required to establish a separate risk management function to review the key risks and report on these to the trustees on a regular basis. This is in addition to the ORA requirement

Self Test Questions

- List three types of individual that the increase in normal minimum pension age will not apply to
- Explain the concept of "View Data" in terms of the pensions dashboard programme
- List the National Cyber Security Centre's 10 steps to cyber security.

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