Pensions
Management
Institute

Learning

Retirement Provision Certificate Study Manual

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A number of acronyms are used throughout the text. They are all written out in full where they first appear. A number of them recur with great frequency. To avoid having to refer back to the original, a list of the most commonly used are given here. Most of them can also be found in Digital Pensions Terminology, which PMI members can access in their member portal.

CGT	Capital Gains Tax
CPI	Consumer Prices Index
DB	Defined Benefit
DC	Defined Contribution
DWP	Department for Work and Pensions
FCA	Financial Conduct Authority
GMP	Guaranteed Minimum Pension
HMRC	His Majesty’s Revenue and Customs
LPI	Limited Price Indexation
NI	National Insurance
NIC or NICs	National Insurance Contribution(s)
NMPA	Normal Minimum Pension Age
NRA	Normal Retirement Age
PAYE	Pay As You Earn
PPF	Pension Protection Fund
RPI	Retail Prices Index
SFP	Statement of Funding Principles
SPA	State Pension Age
TPO	The Pensions Ombudsman
TPR	The Pensions Regulator

PENSIONS INDUSTRY

Origins and overview of pensions
The practice of paying people for work done, once they had ceased to do that work, goes as far back as the 17th century. Initially, the successor paid part of their salary to their predecessor. Subsequently, employers paid pensions to some former workers out of revenue, with no advance funding (called "pay as you go"). In the early 20th century, tax relief was granted on premiums paid by employers to encourage them to fund pensions in advance for former employees.

There has been an enormous amount of legislation since 1980. The legislation that introduced the major milestones in pension development are:
- Social Security Act 1973, which introduced preservation of pensions;
- Social Security Pensions Act 1975, which introduced contracting out and equal access requirements;
- Social Security Act 1985, which introduced revaluation of pensions in respect of pensionable service on and after 1 January 1985;
- Pension Schemes Act 1993, which consolidated previous legislation, including the foregoing;
- Pensions Act 1995, which introduced a number of governance requirements, including a now-defunct minimum statutory funding requirement and provisions for underfunded final salary/defined benefit (**DB**) pensions to be a debt on the employer and introduced pension earmarking requirements on divorce;
- Welfare Reform and Pensions Act 1999, which introduced pension sharing orders on divorce and the requirement for employers to set up (but not contribute to) a stakeholder scheme;
- Pensions Act 2004, which transferred the regulation of pensions from Occupational Pensions Regulatory Authority to The Pensions Regulator ("**TPR**") and strengthened anti-avoidance powers; and introduced the current statutory funding objective for DB schemes;
- The Finance Act 2004, which introduced pension simplification and did away with the concept of "retirement", at least from His Majesty's Revenue and Customs' ("**HMRC**") perspective.

Subsequent developments include:
- Pensions Act 2008, which introduced automatic enrolment, and introduced the National Employment Savings Trust ("NEST") scheme from 2012;
- Pension Schemes Act 2017, which regulates Master Trusts.
- Pension Schemes Act 2021, which regulates and makes provision for collective defined contribution schemes.

Pension provision
Pension provision comes primarily from three sources:
- State pension and other State benefits (see "Role of Government");
- individual provision (See "Individual Provision"); and
- employer-sponsored schemes (See "Workplace Pension Schemes").

In practice, most people have a mix of all three, although many people still rely primarily on State provision. Following the introduction of automatic enrolment, it is hoped that, eventually, employer-sponsored schemes will provide a higher proportion of retirement income than they do now.

Employer-sponsored schemes
There are two types of employer-sponsored schemes in the private sector:
- trust-based occupational schemes; and
- contract-based schemes.

Trust-based schemes

Trust-based schemes can be either DB, or "career average revalued earnings" ("**CARE**"), or money purchase/defined contribution (**DC**). Some trust-based schemes contain a mixture of DB and DC benefits. Contract-based schemes are invariably DC (e.g. stakeholder pensions, group personal pension schemes).

DB means that the members of such schemes can expect to receive pay-related benefits, where the benefit is expressed as a proportion of pensionable pay close to retirement, or date of leaving if earlier, for each year of service. However, an increasing number of members will receive benefits on a CARE basis, where benefits are based on average earnings over their working lifetime with that employer.

DB schemes tend not to be set up now, because of the cost and risk to the sponsoring employer(s). The majority of DB schemes still in operation no longer accept new members and do not permit members to accrue further benefits. Others now have closed down altogether and moved the employed members into DC schemes, mostly contract-based rather than trust-based. Trust-based DC schemes are run by trustees, just like DB schemes, and still require a high level of involvement by the employer. TPR places a heavy regulatory and quasi-regulatory burden on the employers and trustees of trust-based DC schemes, which is why the preference is for contract-based schemes, where the employer's involvement is normally limited to paying over the contractual rate of pension contributions.

In DC schemes, the benefit is the product of the contributions paid in by, and on behalf of, the member, the investment returns achieved while those contributions are invested, and the price of annuities at the time of retirement. Whilst it is now possible for members of DC schemes to "draw" their pensions down, rather than buy an annuity, employers of trust-based DC schemes are generally unwilling to introduce the complexities of drawdown, given the cost involved. If members do not want an annuity, and would rather draw their benefits down, they usually have to transfer the value of their benefits to a personal pension which will permit it.

DC schemes have sometimes contained some form of guarantee (so that the benefit produced is not solely reliant on the product of the investments). These tend to have fallen out of favour because of the problems they can cause and the cost of ensuring the promised guarantee is delivered.

Contract-based schemes

These are not, truly, employer sponsored. Instead, they are a collection of individual personal pensions, to which the employer contributes on behalf of the employee, should they wish to join (or have to be automatically enrolled (see "Role of Government" module for more information on automatic enrolment). To avoid excessive administration on the part of the employer, the individual pension policies are generally all with one provider, usually an insurance company, and are therefore referred to as "group personal pensions".

They provide benefits on a DC basis. The contract is in the name of the employee. When the employee leaves employment, the contract remains with them, and they can continue to contribute to it, should they wish, unlike employer-sponsored trust schemes, where the ability to contribute ends with the termination of employment. The employee has the option of buying an annuity with the proceeds of the contract, or drawing down their pension, either in tranches or all at once, without the agreement of the employer, as is the case with employer-sponsored DC schemes.

Between October 2001 and October 2012, every employer with five or more employees had to provide access to a stakeholder scheme (though employers did not have to contribute), unless they offered an employer-sponsored arrangement which all qualifying employees could choose to join.

The requirement to designate a stakeholder pension scheme ceased to apply with effect from October 2012 when automatic enrolment started.

There are many DC automatic enrolment schemes, ranging from group personal pensions to the Government master trust, NEST. There is more information about automatic enrolment in "Role of Government".

Public sector pension schemes
Public sector schemes are divided between statutory schemes and non-statutory schemes. Statutory schemes have their provisions set out in legislation. The non-statutory schemes are mainly those of the nationalised industries and are usually established by a trust deed and rules, in a similar way to employer- sponsored private sector schemes. A relatively small number of public sector schemes cover millions of employees whereas, in the private sector, smaller groups of employees are covered by thousands of schemes.

The public sector includes public corporations such as the Bank of England and the Civil Aviation Authority and (previously) nationalised industries such as coal mining and railways. The best-known schemes include the Local Government Pension Scheme, The Civil Service Pension Scheme, The Teachers' Pension Scheme, the NHS Pension Scheme and pension schemes covering police, firefighters and armed forces.

Initially, all public sector schemes were DB. The increasing cost of DB pensions has caused some of these public sector schemes to scale back their benefits. Many of them (such as the Civil Service) now consist of a complex mixture of DB, CARE and DC.

Auto-enrolment schemes
Under the Pensions Act 2008, every employer in the UK must put certain staff into a workplace pension scheme and contribute towards it.

Further information about auto-enrolment can be found in the "Role of Government" module.

Master trusts
The Pension Schemes Act 2017 introduces a definition of 'master trust'. A master trust is defined as an occupational pension scheme that:
- provides defined contribution benefits;
- is used, or intended to be used, by two or more employers;
- is not used, or intended to be used, only by employers which are connected with each other; and
- is not a public service pension scheme.

A master trust may also be a group of schemes, none of which are already master trusts, which provide defined contribution benefits, and where each scheme in the group is under "common control" with other schemes in the group. TPR refers to such a group of schemes as "cluster schemes" in its master trust Code of Practice.

Since 1 October 2018, all new master trusts must apply for and obtain authorisation from TPR before they can operate. There are currently 37 authorised master trusts, as recorded on TPR's website.

In 2018, TPR published its master trust authorisation supervision and enforcement Code, which can be found on its website.

The Employment Package
Salary/wages
The basic component of an employment package is cash. As soon as somebody starts work for somebody else, there is an employment contract. These are usually in written form, although this is not always the case, which can give rise to problems in the event of disputes between employer and employee. The contract will normally set out the rate of pay, either hourly, weekly, or annually.

Remuneration from employment is subject to tax, including additional benefits which involve payment of money or are capable of being turned into money.

National Insurance contributions ("**NICs**") are also payable on remuneration. Employees do not have to pay NICs on certain benefits in kind, while employers have to pay NICs on almost all benefits.

There are some exceptions to tax and National Insurance ("**NI**"), the most common being that the first £30,000 of redundancy or termination pay is payable tax-free. The whole of the payment was not liable to any NICs but, from April 2018, any excess over £30,000 is subject to employer NICs.

Components of the employment package which can (and in some cases, must) be paid in addition to basic pay include the "core benefits" of:

- minimum holiday entitlement;
- minimum statutory sick pay;
- minimum maternity pay/paternity pay/leave; and
- minimum pension contributions (subject to the right to opt out).

Other benefits can include:

- cash bonuses/commission based on performance, which are taxed as earned income;
- life insurance, typically a multiple of basic salary and often linked to a pension scheme (see below);
- company cars;
- employee share plans;
- health plans and medical expenses;
- permanent health insurance (see "*Permanent health insurance (PHI)*" below).

Optional benefit packages may contain childcare, dental plans, buying and selling part of holiday allowance, purchase or lease of laptops, access to employee discounts etc. They are usually called "flexible benefit schemes" since employees can opt in and out of them on an annual basis. These flexible benefit schemes frequently involve "salary sacrifice" arrangements, allowing employees to give up salary in return for receiving the additional benefits.

Pension contributions and benefits are commonly calculated on the employee's remuneration, which may include or exclude bonuses and commission.

Ancillary Benefits to Workplace Pension Schemes

As well as paying contributions to workplace pension schemes, employers often provide other benefits, linked directly or indirectly to the pension scheme.

The most common ancillary benefits are:

Life insurance

Most employers provide life insurance for their employees. Often whether they are members of a pension scheme or not, but sometimes only when they are members of a pension scheme. Unlike many other benefits, this is not taxable on the employees.

Trust-based schemes that still have active members accruing benefits normally provide life insurance as part of their benefit structure.

If the trust-based scheme is closed to future accrual, or the employer provides only a contract-based scheme (e.g. a group personal pension scheme or contributes to NEST), life insurance is provided from a separate scheme.

The life insurance usually takes the form of a lump sum, typically a multiple of the member's salary or earnings; otherwise, it may be a flat rate amount.

The benefits are usually paid under trust. This means that the decision as to who receives the lump sum is made by an unconnected third party, usually trustees, or it can be the insurance company itself, depending on how the scheme is structured. The members can let the trustees or managers know to whom they would like the lump sum to be paid in the event of their death, but the trustees/managers are not bound by this "nomination".

The trustees/managers choose the beneficiary or beneficiaries of the lump sum from a class of people included in the scheme rules, which usually comprises:

- spouse/civil partner;
- former spouse/civil partner;
- children, grandchildren, stepchildren, adopted children, their spouses/civil partners;
- siblings and their spouses/civil partners and children;
- parents and grandparents;
- anybody who was financially dependent on the deceased member.

The trustees/managers must make appropriate investigations and select recipients from among the classes permitted by the rules.

The advantage of paying the benefits under trust is that they can be paid immediately, without waiting for grant of probate or letters of administration, which can sometimes take a long time, and the death benefit does not form part of the deceased member's estate for inheritance tax purposes.

Permanent Health Insurance (PHI)

Many DB schemes offer enhanced pension benefits to members who are unable to continue working due to disability, regardless of their age. However, the rules are restrictive, often requiring proof that the member will not be able to work again, in any capacity, at least until the pension scheme's Normal Retirement Age ("**NRA**").

PHI is a contractual benefit offered to employees that provides them with income if they become permanently disabled and unable to work in the capacity in which they were previously employed. Like ill-health retirement from a DB scheme, there are rules, but they are generally less restrictive than DB pension rules for ill health early retirement.

Employees must be paid a minimum of £96.35 statutory sick pay ("**SSP**") per week (2021/22) from their employer for up to 28 weeks, as long as they meet certain qualifying conditions. Many employers supplement SSP under sick pay schemes, sometimes up to full pay, or a proportion of full pay. Once the entitlement to SSP has expired, employees may find themselves reliant on State benefits, and ultimately unable to work again, depending on their level of disability.

It is possible for an employer to provide PHI, on a group basis, for some or all of its employees. Cover is usually arranged with a "waiting period" at the start of any sick leave, usually 28 weeks to fall in line with the SSP payment period. Employers who guarantee pay for longer periods may have a longer waiting period to tie in with the expiry of their sick pay schemes. The longer the waiting period, the lower the premiums.

Every claim is assessed by the insurer based on medical evidence provided by the member's doctor. Once a claim is admitted, benefits are payable to the employer who passes these on to the member via payroll. The benefits are less than the employee's full pay, to encourage them to return to work if possible. All claims in payment will be subject to ongoing medical review. A claim stops when the member has recovered sufficiently to return to work, reached retirement age or dies.

A Group PHI scheme can also cover the employer's pension contributions for the duration of the claim. This enables a sick or disabled employee to remain a member of their pension scheme and continue to build up pension benefits and remain eligible for life insurance.

The termination of the PHI benefit should be tied into the normal retirement age (typically 65) of the pension scheme, to avoid gaps in the cover given to employees.

Parties Involved in Pensions

Pensions-related organisations
Government bodies involved with pensions, which have statutory obligations and regulatory functions, are set out in "Role of Government".

There are many other pensions-related organisations in existence, formal and informal. They are usually trade associations, set up by practitioners in the industry, to represent the interests of the members, and also to educate, inform and share knowledge. The major ones are:

Association of British Insurers (ABI)
The ABI describes itself as "the voice of the UK's world leading insurance and long-term savings industry". It is funded by members' subscriptions on a not-for-profit basis.

It was formed in 1985, and has over 200 member companies, accounting for over 90% of the UK insurance market.

The ABI produces codes of conduct covering all areas of insurance and long-term saving. For example, the Code of Conduct on Retirement Choices required all ABI members to encourage customers to shop around for annuities, rather than simply rolling their pension savings over into an annuity with their existing provider. The Code sets out ways to provide support to consumers approaching retirement. It was designed to make potential retirees aware of different ways to take retirement income, and to improve understanding of how to buy, in order to change this behaviour.

The Association of Corporate Trustees (TACT)
TACT is a registered charity, which was founded in 1974 to foster a high standard of corporate trustee service. It seeks to advance education in trust law and practice through information and instruction. It covers a more diverse group than retirement provision, its members providing:
- Executorships and Private Trusts;
- Loan Capital Trusteeships;
- Pension Trusteeships; and
- Employee Benefit Schemes.

Association of Member-Directed Pension Schemes (AMPS)
AMPS is a trade body which combines the former association of Pensioneer Trustees and the SIPP Providers Group.

AMPS is a specialist organisation, representing the interests of those organisations which provide self-invested personal pensions and those bodies or individuals who act as professional trustees for small self- administered schemes (they used to be called "pensioneer trustees"), (see "**Types of Trustees**" module). These types of pension schemes are, respectively, trust-based personal pension schemes and occupational pension schemes, where the member(s) have the ability to direct the trustee(s) how to invest their funds. In most cases, the members and trustees are the same people.

AMPS makes representations on behalf of its members, to regulatory bodies such as HMRC, the Financial Conduct Authority ("FCA"), HM Treasury ("HMT") and the Department for Work and Pensions ("DWP").

Association of Pension Lawyers (APL)

The APL is a non-profit-making organisation, established in 1984 and run by lawyers who specialise in UK pensions law. Whilst it is not a political organisation, and does not comment on pension policy, it engages with Government on various initiatives, providing practical experience and technical input on legislation and regulatory guidance.

Confederation of British Industry (CBI)

The CBI is a not-for-profit membership organisation, founded by Royal Charter in 1965 when the British Employers' Confederation, the Federation of British Industries and the National Association of British Manufacturers joined together to form the Confederation of British Industry.

Although not, in itself, a pension group, the CBI speaks on behalf of 190,000 businesses, from all sectors, and regularly responds to government consultations on retirement provision on behalf of those members. It also provides expert advice and information.

Chartered Insurance Institute (CII)

The CII is a worldwide professional body, established in 1912 by Royal Charter, which is dedicated to building public trust in the insurance and financial planning professions. Membership is open to anybody working in, or connected with, insurance and financial planning. It provides professional qualifications, ranging from core units to Fellowship.

Pension Administration Standards Association (PASA)

PASA is an independent body which sets standards for pensions administration and provides help and guidance to enable companies to achieve them.

PASA is focused on three core activities:

- defining good standards of pensions administration relevant to all providers, whether in-house, third party or insurers;
- publishing guidance to support those standards; and
- being an independent accreditation body, assessing the achievement of good standards for scheme members and sponsors (regardless of provider).

Pensions and Lifetime Savings Association (PLSA) - formerly the National Association of Pension Funds (NAPF)

The PLSA is a national association with a ninety-year history of helping pension professionals run better pension schemes across master trusts and DB, DC, and local government funds. Members also include some 400 businesses which provide essential services and advice to UK pensions providers.

Its purpose is to help everyone to achieve a better income in retirement. It represents pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Members include asset managers, consultants, law firms, fintechs and others who play an influential role in people's financial futures. Fintechs are financial businesses, which compete with more traditional ones like banks, in the way that they deal with mobile payments, transfers, loans, fundraising and investing: the best known currently are Monzo and Bitcoin.

It is divided into a dozen local groups, each operating autonomously, providing regular meetings and educational seminars.

Pensions Management Institute (PMI)

The PMI exists to promote a high standard of professional conduct among those working in the pensions field. Its members can be those who provide advice, administer schemes, or work on matters connected with retirement provision of all kinds. It is a professional body for its members. PMI offers nationally recognised qualifications at various levels along with the provision of study and examination facilities. It also:

- promotes and embeds professional standards, setting the benchmarks for best practice;
- produces qualifications that have a reputation for excellence and ensures that employee benefits and retirement savings professionals, whether they are scheme managers, consultants, administrators or trustees, are educated to the very highest standards and the latest legislation;
- provides continued lifelong learning designed to strengthen the knowledge and skills of employee benefit and retirement savings practitioners in performing to the best of their ability;
- plays a pivotal role shaping the industry, working with Government and collaborating with other bodies on research and thought leadership on key issues;
- presents an annual conference and a wide range of technical seminars from entry-level to those for highly experienced professionals;
- provides industry-leading insight, including Pensions Aspects, PMI TV, Insight Partner insights, papers, newsletters and blogs to keep practitioners abreast of the very latest developments in a rapidly changing industry; and
- proactively has a voice in mainstream and social media with a presence on Twitter and LinkedIn.

Pensions Policy Institute

The Pensions Policy Institute (PPI) was launched in January 2002 by the Pension Provision Group, who recommended that an organisation independent of government needed to lead responsibility for accumulating, analysing, and publishing information about current and future pension provision and its implications for future pensions policy. They carry out original research and compile existing information to inform the analysis of the whole pensions policy framework.

Pensions Research Accountants Group (PRAG)

PRAG was founded in 1976. PRAG consists of the accountants and pension managers of UK occupational pension schemes, together with practitioners in the actuarial, consultancy and auditing professions who are interested in the financial administration and reporting of pension schemes.

PRAG's primary functions are to produce publications on various pension topics, and to sponsor research into the financial administration and reporting of schemes. The reports are prepared by working parties that are set up for that specific purpose. The working parties are made up of specialist or interested members of the Group and often include individuals from outside the Group to contribute to the deliberations.

During 1996 PRAG was recognised by the Accounting Standards Board as the appropriate organisation to issue Statements of Recommended Practice (SoRPs) for pension schemes resulting in the publication of a new SORP entitled "Financial Reports of Pension Schemes" in July 1996, updated in November 2002, and further revised in 2007 and 2015.

The Society of Pension Professionals (SPP)

Founded in 1958, membership of this society is open to a wide range of providers of advice and services to workplace pension schemes and their sponsors. Firms such as accountants, insurance brokers, merchant bankers, solicitors, life offices, investment houses, investment performance measurers, consultants and actuaries, independent trustees and external pension administrators, are all eligible. It is an independent body and concerned with the business of its members as pensions professionals.

Unlike a number of industry-representative groups, such as AMPS, the SPP focuses on the whole range of pensions-related services across the private pensions sector and through a wide spread of providers of advice and services.

The Society has three fundamental aims:

- influencing policy and strategy – to draw upon the knowledge and experience of members so as to contribute to and influence legislation and other general developments affecting pension and related benefit provision. The Society is consulted by a broad range of policy forming and regulatory bodies.
- member services – to provide members with access to technical information and insight into the key policy debates in the industry; and
- industry profile – the Society helps raise the profile of all members and to help address practical industry issues on their behalf.

Professions involved in Pensions

The Pensions Act 1995 requires trust-based occupational pension schemes to appoint certain advisers. These advisers must be appointed by the trustees, not the employer(s). All appointed advisers, whether statutory or not, have certain duties that can override their duty of confidentiality to their clients, such as reporting breaches of the law to TPR (called “whistleblowing”). If a statutory adviser is not appointed where required, it must be notified to TPR, who can take action against the trustees.

Even though trustees have to engage certain advisers and may choose to appoint others, they remain responsible for the running of the scheme.

Actuary

All funded DB and CARE pension schemes must appoint a Scheme Actuary. They can have other actuarial advisers as well, should they so wish. To become an actuary in the UK, it is necessary to be a Fellow of the Institute and Faculty of Actuaries.

The Scheme Actuary has statutory duties, set out in the Pensions Act 2004, in relation to scheme funding. Basically, trustees must have their schemes valued by a Scheme Actuary at least every three years and, if they have 100 or more members, obtain annual actuarial reports. They also have to produce a range of certificates, such as a schedule of contributions, a recovery plan if the scheme is in deficit, a statement of investment principles (“SIP”) (if they have 100 or more members) and statement of funding principles (“SFP”). The trustees must obtain the advice of the Scheme Actuary before:

- making any decision as to the methods and assumptions to be used in calculating the scheme’s technical provisions;
- preparing or revising the SFP;
- preparing or revising a recovery plan;
- preparing or revising the schedule of contributions;
- modifying the scheme as regards the future accrual of benefits by resolution.

Accountant

All occupational pension schemes must have an auditor, with the exception of those with only one member. Audited accounts must be produced annually, within seven months of the end of the scheme’s year-end. Failure to do so must be reported to TPR.

Accountants can have other responsibilities in the pension sphere. For example, an insolvency practitioner (who is normally a chartered accountant) is appointed to an employer with a final salary scheme following that employer becoming insolvent. The insolvency practitioner is required to make reports to the Pension Protection fund (“PPf”) and TPR about the existence of the scheme and whether there is any possibility of the scheme being “rescued” (i.e. taken over by another employer).

Fund manager
Every occupational pension scheme which has "investments" (within the meaning of the Financial Services and Markets Act 2000) must have an individual or a firm appointed by or on behalf of the trustees or managers as fund manager. Pension schemes may split their investments between several fund managers, to spread risk, or put the investments under the control of a fiduciary, which manages a range of fund managers on behalf of the trustees. It is common for fund managers to offer other services bundled into their investment services, such as custodian services.

Independent Financial Adviser (IFA)
It is not a statutory requirement to appoint an IFA. Schemes may do so if, for example, they are thinking about securing benefits with an insurance company, either for a single member, or for a class of members. IFAs dealing with "regulated products", such as annuities, should be authorised by the FCA or the Prudential Regulation Authority ("PRA").

Lawyers
It is not a statutory requirement to appoint a legal adviser to a pension scheme. Most schemes do, either on a permanent basis, or they use legal services as and when required. The term "lawyer" is generic and has no special meaning. The legal profession in England and Wales (Scotland and Northern Ireland are separate legal jurisdictions) is separated into solicitors and barristers. Both these professions are regulated: solicitors by the Solicitors Regulation Authority and barristers by the Bar Council. Depending on the type of work they undertake in addition to advising on pensions, many solicitor firms are also regulated by the FCA. Solicitors are most commonly used by trustees to advise on the effects of new legislation, changing scheme documents and dealing with general problems that arise from time to time. Barristers tend to be used less often, usually only when highly specialised advice is needed on a complex issue, or the trustees require representation in court.

Consultants
Many trustees appoint a firm of consultants to advise them on the day to day running of their schemes. In some cases, the consultants are firms, or associated firms of the firms, that provide other services (e.g. actuarial services).

Third party administrators
Trustees often engage separate firms to provide administration services. They are the first port of call for members with queries and they normally calculate retirement and death benefits, set the benefits up and make regular pension payments on behalf of trustees.

ROLE OF GOVERNMENT

Statutory bodies
There are a number of Government bodies that are involved in pensions and saving. These bodies have varying degrees of statutory authority to regulate and police workplace pension schemes. The principal statutory bodies are:

The Department for Work and Pensions (DWP)
The DWP is responsible for welfare, pensions and child maintenance policy. As the UK's biggest public service department, it administers the State Pension and a range of working age, disability and ill health benefits to around 20 million claimants and customers.

The DWP is also responsible for most of the non-tax-related legislation affecting workplace pension schemes, even where no link with the State scheme is involved. For example, the DWP consulted on draft changes to the Disclosure Regulations (see "Disclosure of Information" below) to introduce new requirements for trustees to build in a "nudge" to members, who want to make use of flexible access, to take pensions guidance (e.g. from Pension Wise) and to require members (and other relevant beneficiaries) to make an active choice to opt out of receiving guidance. The consultation resulted in regulations that, from 1 June 2022, require scheme trustees to take certain steps under such circumstances.

Trustees can trace missing beneficiaries through the DWP's bulk letter forwarding service. DWP will send information from pensions, insurance companies and solicitors to named people, using their tracing and letter forwarding service. DWP will let trustees know if the beneficiary has died but will not disclose any addresses. If the beneficiary receives a letter from trustees via the service but does not (or is unable to) respond, the trustees cannot make contact by this method.

The Pension Service
The Pension Service is part of the DWP. It provides its customers with pensions, benefits and retirement information – for example, State Pension and Pension Credit.

The Treasury
HMT is the government's economic and finance ministry, maintaining control over public spending, setting the direction of the UK's economic policy, and working to achieve strong and sustainable economic growth.

HMT is a ministerial department, supported by 15 agencies and public bodies. Consequently, HMT has increasingly taken a direct involvement in pension matters, mainly through HMRC.

His Majesty's Revenue and Customs (HMRC)
HMRC is the UK's tax, payments and customs authority, which collects the money that pays for the UK's public services and helps families and individuals with targeted financial support. It reports to Parliament through the Treasury minister who oversees its spending.

HMT leads on strategic tax policy and policy development, which includes setting the Lifetime and Annual Allowances (LTA and AA respectively) for pensions each year. HMRC leads on policy maintenance and implementation.

Its strategic objectives for 2022 are to:
- Collect the right tax and pay out the right financial support
- Make it easy to get tax right and hard to bend or break the rules
- Maintain taxpayers' consent through fair treatment and protect society from harm
- Make HMRC a great place to work
- Support wider government economic aims through a resilient, agile tax administration system

HMRC is responsible for registering pension schemes for tax relief and also de-registering schemes if they do not meet the requirements of a registered pension scheme; HMRC's powers in this area have been increased in recent times to help it combat pension frauds and scams. In addition to receiving information which scheme administrators and others must provide by law, HMRC also has information notice and inspection powers so that it can ensure that the requirements are, and continue to be, met and it can also apply penalties and prosecute where necessary where the requirements are not met.

Pension Schemes Online Service is available for schemes registered with HMRC before 4 June 2018. Schemes registered after this date must use the Managing Pension Scheme services. Both services are accessed online.

The services are used to update scheme details, such as name, trustees/managers, add and remove scheme administrators and make returns, both statutory and voluntary.
HMRC provides a great deal of information about pension administration on dedicated pages. Among the many topics covered are:

- tax manuals that provide detailed guidance on tax issues affecting pension schemes; and
- pension scheme newsletters.

National Insurance Services

NICs are largely collected from workers paid through Pay As You Earn ("PAYE"), by employers alongside Income Tax, on behalf of HMRC. Both PAYE and NICs are collected from employees and submitted through "Real-time information" ("**RTI**") which is an electronic link with HMRC. Under RTI, information about tax and other deductions under the PAYE system is transmitted to HMRC by the employer every time an employee is paid. Employers using RTI are no longer required to provide information to HMRC after the end of the tax year. Since April 2014 all employers have been required to report in real time.

NI is now dealt with by HMRC.

HMRC also provides a number of services to help pension scheme administrators of formerly DB contracted-out pension schemes.

The Scheme Reconciliation Service allows pension scheme administrators (who must have registered for the service by 5 April 2016) to reconcile their membership and guaranteed minimum pension ("**GMP**") data against the records held by HMRC following the ending of DB contracting out in April 2016. The Scheme Reconciliation Service itself is closed to new enquiries.

Until 2019, HMRC released a series of Countdown bulletins providing additional guidance for pension scheme administrators on the ending of DB contracting out in April 2016. They can be found on its website.

Financial Conduct Authority (FCA)

The FCA is the conduct regulator for 59,000 financial services firms (including investment advisers and others offering services to consumers) and financial markets in the UK and the prudential regulator for over 18,000 of those firms.

Its strategic objective is to ensure that the relevant markets function well. Its operational objectives are to:

- protect consumers by securing an appropriate degree of protection for them;
- protect financial markets by protecting and enhancing the integrity of the UK financial system; and
- promote effective competition in the interests of consumers.

The FCA is an independent public body, funded entirely by the firms it regulates by charging them fees. It is accountable to HMT, which is responsible for the UK's financial system, and to Parliament.

Its work and purpose are defined by the Financial Services and Markets Act 2000. The FCA authorises those permitted to provide investment advice. It also works with consumer groups, trade associations and professional bodies, domestic regulators and a wide range of other stakeholders. It uses a proportionate approach to regulation, prioritising the areas and firms that pose a higher risk to its objectives.

The FCA produces a publicly accessible register of firms and individuals that are, or ever have been, regulated by it and the PRA. The register now also includes firms selling regulated products by entities not authorised to do so, with prominent warnings.

It also produces a handbook of its legislation, rules and guidance. In some respects, the FCA's work mirrors that of TPR. For example, it also requires publication of costs and charges data for contract-based schemes and is looking to require asset managers, life insurers and FCA- regulated pension providers to report on how they deal with climate-related risks.

Prudential Regulation Authority (PRA)

The PRA, part of the Bank of England, is the prudential regulator of around 1,500 banks, building societies, credit unions, insurers and major investment firms. As a prudential regulator, it has a general objective to promote the safety and soundness of the firms it regulates.

The Pensions Regulator (TPR)

TPR is a public body sponsored by the DWP. It works closely with the FCA, which regulates personal pension schemes and with other public bodies including DWP and PPF

TPR's remit is to protect the UK's workplace pensions, by promoting their good administration, and making sure employers, trustees, pension specialists and business advisers fulfil their duties to scheme members. It has also been given responsibility for regulating the governance and administration of public service schemes and the authorisation and supervision of master trusts. Its aims are:

- making sure employers put their eligible staff into a pension scheme and pay money into it (known as "automatic enrolment");
- protecting people's savings in workplace pensions;
- improving the way that workplace pension schemes are run;
- reducing the risk of pension schemes ending up in the PPF; and
- making sure employers balance the needs of their DB pension scheme with growing their business.

One of TPR's main areas of interest is its fight against pension "scams", particularly following the new pension flexibilities introduced in April 2015; it provides guidance on avoiding scams to scheme trustees, members and pensions professionals.

TPR has produced an extensive library of guidance and Codes of Practice. It has introduced a voluntary "pledge to combat pension scams" for trustees and other pension professionals to:

- regularly warn members about pension scams
- encourage members asking for cash drawdown to get impartial guidance from MoneyHelper
- get to know the warning signs of a scam and best practice for transfers by completing the scams module in the Trustee Toolkit and encouraging all relevant staff or trustees to do so; studying and using the resources on the FCA's ScamSmart website, and the Pension Scams Industry Group code; considering becoming a member of the Pension Scams Industry Forum.
- take appropriate due diligence measures by carrying out checks on pension transfers and documenting pension transfer procedures
- clearly warn members if they insist on high-risk transfers being paid
- report concerns about a scam to the authorities and communicate this to the scheme member. TPR is also responsible for monitoring and enforcing automatic enrolment.

TPR has extensive powers, set out in legislation, including powers to intervene where employers, directors and majority shareholders are perceived to be avoiding their responsibilities to pension schemes and where employers are insufficiently resourced to support the pension scheme. It can levy fines and penalties for breaches of the law, although it prefers to assist and educate in the first instance. Its authority to do so is derived from the Pensions Act 2004.

Amongst its raft of powers are:

- issuing a contribution notice, requiring a specified sum of money to be paid to the relevant scheme (or the PPF, if it has assumed responsibility for the scheme) by an employer, individual or somebody (including another company), where TPR had deemed that they were party to a failure to fund a scheme properly;
- issuing a financial support direction, which requires the recipient to put in place financial support for the scheme, which must remain in place while the scheme is in existence;
- making a restoration order where there has been a transaction at an undervalue involving scheme assets. This can happen where, for example, an employer sells a commercial property to its pension scheme and leases it back, but the sale and purchase prices, and rental, are not at arms'-length terms;
- fining trustees and employers and, in more serious cases, removing trustees from the scheme and replacing them with trustees from TPR's register of professional trustees. Trustees can be banned from acting as trustees of one scheme or banned from acting as trustees of any scheme;
- instituting proceedings for criminal offences. Examples of those offences include:
  - failing to comply with automatic enrolment duties;
  - acting as a trustee when disqualified;
  - neglecting, or refusing, to produce documents, answer questions in relation to, or cooperate with inspections.

The Pension Schemes Act 2021 gave TPR stronger powers with effect from 1 October 2021.

TPR now has the power to impose a fine of up to one million pounds to anyone who fails to comply with its powers and functions.

TPR can issue three types of penalty notice:

* Fixed penalty notice
* Escalating penalty notice
* "Prohibited recruitment conduct" penalty notice.

The Pension Protection Fund (PPF)

The PPF was established to pay compensation to members of eligible DB pension schemes, when there is a "qualifying insolvency event" in relation to the scheme employer, and where there are insufficient assets in the pension scheme to cover PPF levels of compensation.

The PPF is a statutory fund run by the Board of the Pension Protection Fund, a statutory corporation established under the provisions of the Pensions Act 2004. The PPF became operational on 6 April 2005. In order to be eligible for entry into the PPF, certain basic conditions have to be met:

- the scheme must have commenced wind up after 6 April 2005;
- the scheme's employer has become insolvent;
- the scheme cannot be rescued (i.e. taken over by somebody else); and
- the scheme has insufficient assets to secure benefits on wind-up that are at least equal to the compensation that PPF would pay if it assumed responsibility for the scheme.

To help fund the PPF, compulsory annual levies are charged on all eligible schemes.

Once the PPF has assumed responsibility for a scheme, benefits will be paid at the PPF level of compensation, which is, broadly speaking:

- 100% for pensioners over the scheme's NRA, dependants and those receiving ill health pensions; and
- 90% for all other members until age 65.

Only benefits accrued during pensionable service on and after 6 April 1997 will increase during payment, at CPI capped at 2.5%.

The DB assets of the schemes entering the PPF are transferred to the PPF. DC assets are not transferred to the PPF and must be used to secure benefits outside the scheme.

The Financial Assistance Scheme (FAS)

FAS was set up under the provisions of the Pensions Act 2004, to protect members who had DB benefits in a workplace pension scheme, where:

- the employer became insolvent before 28 February 2006;
- the pension scheme started to wind up between 1 January 1997 and 5 April 2005; and
- the pension scheme could not afford to pay benefits promised to members on wind-up, usually where the sponsoring employer became insolvent.

FAS benefits are regarded as "compensation" and are paid in the form of a top-up, which aims to provide members with 90% of the DB pension that they would have received at their scheme NRA. There is a cap on benefits, of £36,901 per annum (2021/22). The cap is increased in line with increases to inflation, measured annually from September to September.

FAS is now operated by the PPF. There is an extensive library of booklets explaining how it works on its website.

FAS was closed to notification and qualification of new schemes in September 2016.

The Pensions Ombudsman (TPO)

TPO can look at complaints about personal and occupational pension schemes, the actions, and decisions of the PPF and some decisions made by the FAS. It will not adjudicate on Social Security benefits or disputes with HMRC.

Its main activity is to investigate complaints from members against trustees and employers, about injustice caused by scheme maladministration. Its determinations are final, except on points of law, where an appeal to the courts is possible.

There is some cross-over between TPO and the Financial Ombudsman Service in dealing with complaints. Accordingly, the two organisations have produced a “memorandum of understanding”.

TPO is, in effect, a tribunal, whose decisions are enforceable in the County Court. Decisions (known as “Determinations”) are publicly available on TPO’s website.

Among the remedies that can awarded by TPO are:

- ordering trustees and/or employers to revisit decisions they have made because they did not make them properly in the first place;
- pay the correct level of benefits where this has not been carried out properly e.g. if mistakes were made in calculating entitlements;
- ordering trustees and/or employers to make cash payments, for distress and inconvenience, to employees/pension scheme members who have experienced difficulty in dealing with those employers/ trustees in establishing the correct decision-making process and/or ascertaining the correct level of benefits.

TPO is a free service and does not require legal representation. A complaint to TPO must normally be made in writing within 3 years of a dispute or complaint arising.

Money and Pensions Service (MaPS)

The Money and Pensions Service is sponsored by the DWP and also engages with HMT, which is responsible for policy on financial capability and debt advice.

MaPS provides free and impartial money and pensions guidance for people across the UK.

It is committed to ensuring that people throughout the UK have guidance and access to the information they need to make effective financial decisions over their lifetime.

Its consumer-facing service is MoneyHelper, which was created in June 2021, and which brings together the financial guidance services and content from previous legacy brands.

One of its most important services, as far as work-based pension schemes are concerned, is Pension Wise. It offers free, impartial guidance to over 50s, by explaining the options to take money from their pension pots.

MaPS is committed to ensuring everybody in the UK can access information needed to help them make the right financial decisions. It is also the largest single funder of free debt advice in England.

Financial Ombudsman Service

The Financial Ombudsman Service settles individual disputes between consumers and businesses that provide financial services. There is some cross-over with TPO's services (see above).

The Financial Ombudsman Service does not deal exclusively with pension problems and disputes. It also deals with:

- bank accounts, payments and cards;
- payment protection insurance;
- home, car, travel and other types of insurance;
- loans and other credit, like car finance;
- debt collection and repayment problems;
- mortgages;
- financial advice, investments and pensions.

Its service is free for consumers and does not require legal representation.

Government Actuary's Department (GAD)

GAD is a non-ministerial department, that dates back to 1912. Its mission is to improve the stewardship of public sector finances by supporting effective decision-making and robust financial reporting through actuarial analysis, modelling and advice.
It provides analysis and commentary on complex financial problems involving risk and uncertainty to solve financial challenges faced by the UK public sector in:

- insurance and investment
- data, modelling and quality assurance
- pensions and social security

Information Commissioner's Office (ICO)

The ICO is the UK's independent body set up to uphold information rights. The mission of the office of the Information Commissioner is to uphold information rights in the public interest, promoting openness by public bodies and data privacy for individuals. The Information Commissioner rules on eligible complaints, gives guidance to individuals and organisations, and takes appropriate action when the law is broken.

The ICO's services are free to consumers. The Data Protection Act 1998 was replaced by the Data Protection Act 2018 (DPA 2018), when the General Data Protection Regulation ("GDPR") was implemented with effect from 25 May 2018. The DPA 2018 introduced new contractual obligations, enhanced reporting obligations and tougher enforcement and/or sanctions for non-compliance.
More information on the DPA 2018 is given in "Workplace Pension Schemes".

National Employment Savings Trust (NEST) Corporation

NEST was created as part of the Government's pension reforms to help employers meet their new duties for automatic enrolment. The NEST Corporation is a non-departmental public body that operates at arms' length from Government. It is accountable to Parliament through the Secretary of State for Work and Pensions. The DWP is the sponsoring department of the NEST.

The Trustee is comprised of up to 15 Board Members and the employees of Nest Corporation. The Board Members are collectively referred to as the Board of Nest Corporation, or simply the Board. They're supported by an executive team and a range of specialists who aim to make sure Nest works in the way it should.

Pension Tracing Service
The Pension Tracing Service is accessed through the GOV.UK website. It operates a free tracing service for individuals who think they may have pension benefits but are not sure of the details or who have lost contact with a previous employer and their pension scheme.

The Pension Tracing Service has access to a database of over 200,000 occupational and personal pension schemes and can be used, free of charge, to search for a scheme. Individuals can access this service by phone, post or online.

State Benefits
In the UK, retirement income is provided partly by the Government, to those who have contributed towards it by means of a set number of years paying NICs. Employed persons have NI deducted from their earnings directly through the payroll operated by their employer. Self-employed persons pay NI through their annual self-assessment return. In addition, paying NICs can make people eligible for other State benefits.

State Pension
The origins of the State Pension go back centuries, in this case, to Roman times. The first "old age" pension (as we understand it now) was introduced by the Government in 1908, when five shillings per week (worth around £30 per week today), was paid to men over the age of 70. The average male life expectancy was 47, so very few men lived long enough to claim it. The universal State pension was introduced in 1948, at the rate of £1.30 per week (equivalent to just over £45 per week today). State Pension Age ("SPA") was set at 65 for men and 60 for women. Life expectancy for men was 65 and for women, 70. The apparent generosity of providing women with a State pension for longer periods of time was offset by the fact that most women did not build up the necessary contribution records and received only a proportion of their husband's State pension as a widow's benefit, following their husband's death.

Increasing State Pension Ages
Increases to SPA were introduced by the Pensions Act 1995. The SPA started to increase for women in 2010 and equalised with the (then) male SPA of 65 in 2018. Originally, female SPA was intended to equalise at 65 in 2020, but the increase timetable was brought forward. It is now 66 for everybody, rising to 67 between 2026 and 2028. It will rise from 67 to 68 between 2044 and 2046. Whilst the default retirement age ("DRA") of 65 for employment purposes was phased out between 6 April and 1 October 2011, occupational pension schemes can still set their own NRA, within HMRC's rules.

New State pension
The original, complicated system of State pension provision, involving paying benefits to widows and (since 2008), widowers was replaced on 6 April 2016, by the single State pension, whereby those reaching SPA, on and after 6 April 2016 only, will receive a State pension based on their own NI record, less an offset for any GMP paid as part of an occupational pension. This replaces the extremely complicated State benefit system, whereby spouses, ex-spouses and civil partners could inherit part of their late and ex-spouse's/civil partner's State pension rights. The old system will continue to apply to those who reached SPA on and before 5 April 2016.

Under the new system, a minimum of 10 qualifying years (i.e. tax years paying, or being credited with, NICs) will be needed to qualify for State pension. 35 qualifying years will be needed to achieve full State pension (£179.60 per week for 2021/22).

Between 10 and 35 qualifying years will achieve a proportion of full State pension. For example, 20 qualifying years will give rise to 20/35 x £179.60 = £102.63 per week.

The amount by which the State pension rises annually in payment is determined by what is known as the "State pension triple lock". This guarantees that the State pension will rise in line with inflation, wage growth or 2.5%, whichever is highest for the September figures. However, the Government did not honour the triple lock in 2022/2023. State pensions rose only by 2.5% instead of the 8% the triple lock would otherwise have guaranteed. It will be reinstated in 2023/24.

It is possible to defer taking State pension, indefinitely, in which case it will start to increase after a certain period of deferment. People may wish to do this if, e.g., they are still earning, since State pension will be added to their wage and taxed as earned income.

Deferred State pension increases by the equivalent of 1% for every 9 weeks of deferment. This works out as just under 5.8% for every 52 weeks.
The extra amount is paid with the regular State pension payment.

Other State Benefits
The DWP provides a wide range of State benefits to supplement money received in work and retirement. There are also benefits to assist during periods out of work and illness. There are too many to list here. They are complicated and have many conditions attached to them. The Citizens Advice website has detailed information about State benefits.

Examples of State Benefits:
- Child benefit (qualification for this is not dependent on sufficient NI contributions and the claimant is not penalised for having savings or investments) for each child provided:
  - the claimant is 'responsible for the child', and
  - the child is under 16 years old - or 16 to 20 years old and still in education or training.

Child Benefit will be clawed back in tax if the claimant's individual income is over £50,000 per annum.

- Help with council tax. Reduction in council tax, up to 100%, is available for those on a low income or claiming benefits. Applicants can own their home, rent, be unemployed or working. It is paid by way of a discount on council tax bill for those eligible. Each council runs its own scheme.
- Benefits for those on a low income, whether in work, out of work, or in receipt of certain benefits.
  - Job-seeker's allowance ("JSA") if the claimant is working less than 16 hours a week, among other conditions;
  - Various tax credits, as part of Universal Credit;
  - Universal Credit ("UC"), which is a new benefit, gradually replacing;
- Child Tax Credit;
- Housing Benefit;
- Income Support;
- income-based JSA;
- income-related Employment and Support Allowance;
- Working Tax Credit.

UC was introduced by the Welfare Reform Act 2012 and rolled out gradually from 2013, initially for new claimants and people with simple circumstances. It replaces and combines six benefits (as listed above) for working-age people who have a low household income, whether in work, out of work, or in receipt of certain benefits.

The purpose of replacing a complex system, that distinguished between those in work and those out of work, with one benefit that is based purely on household income, is that payments to those not in employment will taper off as the recipient moves into work, and not suddenly stop, even if the employment income is less than State benefits. This is intended to avoid a ‘cliff edge’ that trapped people in unemployment.

Further examples of State benefits include:
- Benefits for disabled people; including
  - Personal Independence Payment;
  - Disability Living Allowance;
  - Attendance Allowance;
  - Benefits for accidents at work and industrial diseases;
  - Benefits for people injured in the Armed Forces;
- Benefits during retirement
  - Pension Credit, and
  - many of the benefits available to people in work with low incomes;
- Benefits following bereavement;
  - Help to pay for a funeral;
  - Bereavement Support Payment; and
- Many of the benefits available to people in work with low incomes

Regulation and policing of workplace pension schemes

Pensions Tax Regime
The references to “scheme administrator”, below, is to the person or persons who are responsible for payment and collection of tax to HMRC, and for carrying out the functions set out in the Finance Acts. The “scheme administrator” for this purpose is normally the trustees, not a firm employed to administer the scheme on a day-to-day basis, which is also sometimes referred to as the scheme administrator.

Employers are free to set up pension schemes on any basis they wish. They will, however, only receive attractive tax benefits if they remain within the parameters set out by HMRC in the Finance Act 2004. The process of obtaining these tax benefits is called “registration” and schemes that have been registered are called “registered pension schemes”.

Payments made from registered pension schemes can only be paid on:
- retirement;
- death;
- having reached a particular age; and
- onset of serious ill health or incapacity.

Schemes that were “approved” under the pre-2006 tax regime automatically became “registered” on 5 April 2006. A scheme set up on and after 5 April 2006 must apply to be registered with HMRC. The scheme administrator (in this case, the person legally responsible for adhering to HMRC’s tax rules and making returns and payments to HMRC) must make certain declarations for this purpose. These declarations include a statement that the scheme’s governing instrument does not entitle any person to receive unauthorised payments.

HMRC must register the scheme unless certain circumstances apply.

Registered pension schemes, and their members, are taxed on the “EET principle”. The contributions and investment returns are exempt from income, capital gains and inheritance taxes. Retirement income is taxed, as earned income.

The tax advantages enjoyed by registered schemes (whether occupational or personal) are:
- both employers and employees can claim income tax relief on contributions;
- contributions made by an individual’s employer to a registered pension scheme are not liable to income tax or NICs as a taxable benefit-in-kind;
- income from investment returns is exempt from income tax, except in relation to trading income, dividends from shares owned by the pension scheme or property investment limited liability partnerships;
- gains received on realising investments are exempt from capital gains tax; and
- Value Added Tax (“VAT”) payable by employers on management services provided by a third party relating to a funded pension scheme is recoverable, although there are issues about the recoverability of VAT on investment services.

The authorised payments a registered scheme can make fall into several categories:
- payments of pensions;
- payments of lump sums;
- death benefits payable to a member’s surviving spouse, dependants or other beneficiaries;
- transfer payments to other pension schemes;
- payments required under a pension-sharing order on divorce or dissolution of a civil partnership;
- payments to members in connection with the administration of the scheme;
- payments to cover the provision of retirement financial advice from a regulated financial adviser; and
- payments to a scheme’s sponsoring employer or employers.

Tax allowances
More information is given in “Workplace Pension Schemes” about:
- Annual Allowance;
- Lifetime Allowance (“LTA”); and
- tax relief on employer and employee contributions.

Unauthorised payments
Payments made by or on behalf of registered schemes to either employers or members, which do not fall within the allowable authorised payments regime outlined above, are called “unauthorised payments”. It does not cover just payments of money, but also transfers of assets and other non-monetary benefits.

Payments treated as unauthorised include:
- assignment or surrender of pension benefits. It is possible to surrender part of a pension entitlement to provide a pension for, or increase a pension to, a dependant. It is also possible to reduce one person’s pension in favour of another on a divorce (“pension sharing”). But surrendering, or attempting to pass ownership of, a pension benefit to another, e.g. to pay off a debt, is an unauthorised payment.
- scheme pensions. It is possible for authorised pension payments to become unauthorised in circumstances such as where a scheme pension has become payable and the rate of the pension is then reduced, unless it falls within the specific circumstances permitted by HMRC.

Tax charges on pension schemes

- pensions and annuities are subject to income tax in the hands of the recipient;
- lump sums paid on commencement of pension and serious ill health lump sums (where the whole pension is commuted for a lump sum) are free from income tax in the hands of the member receiving them;
- 25% of a trivial lump sum (where the amount of pension available is so small that the whole of it may be taken as a lump sum, or the amount is less than £10,000) is free from income tax. The balance is taxed as though it were income; and
- lump sums paid on the death of a member are subject to a different tax regime to those paid to the member before death.

Tax charges (other than on lump sums paid as death benefits) take the following forms:

- LTA charge, where the value of the member's benefits (DB or DC) exceeds the LTA. The charge is 25% on the excess over the LTA if taken as a pension and 55% if taken as a lump sum;
- AA charge ("AAC"). Contributions by or on behalf of a DC member, and the value of accrual for a DB member in excess of the AA attracts a charge of 20% for a basic rate taxpayer and 40% for a higher rate taxpayer. Contributions/accrual in excess of the additional rate threshold are taxed at 45%;
- Where the AAC exceeds £2,000 in a year, the charge can be paid from the member's pension fund, under a system called "scheme pays";
- Unauthorised payments surcharge. Unauthorised member payments that exceed a specified proportion of the member's benefits will attract a surcharge, over and above the unauthorised payments charge;
- An unauthorised payment made to or in respect of a sponsoring employer can also attract an unauthorised payments surcharge. This can happen if the payment is part of a series of payments made, by the same registered pension scheme to or in respect of that employer, during a 12-month reference period and where the payments made exceed the surcharge threshold; and
- Scheme sanction charge. This charge is levied on the scheme itself, if it makes unauthorised payments, enters into unauthorised borrowing (which would be permissible loans, but which do not meet HMRC's requirements) and income or gains accrued from taxable property. The charge is 40% of the scheme chargeable payment.

As a general rule, the tax charges on unauthorised payments, set out above, are paid either by the member or the employer, depending on which of them is the recipient of the unauthorised payment. If the unauthorised member payment was made after the member's death, the recipient of the payment is liable for the charge. It is possible for several people to be jointly and severally liable for a tax charge.

- De-registration charge. Where HMRC has de-registered a scheme, a tax charge of 40% of the value of the assets immediately before the registration is removed. It is paid by the scheme administrator, direct to HMRC.

HMRC must de-register a scheme under certain circumstances, including:

- the scheme has not been established (or is not being maintained) wholly or mainly for the purpose of making authorised payments of pensions or lump sums. An example of this would be a scheme set up to operate a pension scam;
- the scheme administrator is not a fit and proper person to fulfil that role;
- scheme chargeable payments made by the scheme in a 12-month period exceed a permitted threshold, which broadly speaking is 25% of the scheme assets;
- the scheme administrator fails to pay a substantial amount of tax due;
- the scheme administrator fails to provide information requested by HMRC under its information-gathering powers, and the failure is significant;
- any information contained in the scheme's application for registration (or otherwise provided to HMRC) is inaccurate in a material particular;

- the scheme administrator fails to produce any document required to be produced by HMRC, or that any document produced to HMRC contains a material inaccuracy which is not notified and corrected;
- any declaration made by the scheme administrator accompanying the registration application (or otherwise made to HMRC) is false in a material particular;
- the scheme administrator has deliberately obstructed HMRC in the course of an inspection;
- there is no scheme administrator;
- the pension scheme is an occupational pension scheme, and a sponsoring employer in relation to the scheme is a company that has been dormant during a continuous period of one month within the preceding year; and
- The scheme is an unauthorised master trust.

Taxation of lump sum death benefits.
The taxation of lump sum death benefits is very complicated. It depends on whether the member was under or over age 75 when they died, whether they had triggered all of their benefits before death and to whom the death benefit is paid. As a general rule, if a member dies before the age of 75, any death benefits (within the member's LTA) paid to a dependant or other beneficiary will be paid free of income tax. If the member dies after reaching the age of 75, the recipient will usually be liable for income tax on the benefits they receive, at their marginal tax rate. Under certain circumstances, tax can be charged if the lump sum death benefit is not paid within two years of the member's death.

Inheritance Tax (IHT).
In most circumstances, IHT is not paid on, or in respect of, pensions. However, it is still possible for HMRC to determine that funds remaining on the death of a member will be subject to IHT. Broadly speaking, these circumstances are:
- where the member knows they are in ill health and they and/or their employer start to pay pension contributions, or significantly increase their existing pension contributions within two years preceding the death of the member; or
- the member knows they are in ill health and, within two years preceding death, transfers their benefits to another registered pension scheme which (for example) pays death benefits under a different form of trust. For example, the originating scheme pays death benefits only to the member's estate, but the receiving scheme pays death benefits out under discretionary trusts, bypassing the estate.

Although HMRC considers a period of two years prior to the member's death as the significant period, this is only a rule of thumb. HMRC reserves the right to look further back if it considers circumstances warrant it.

IHT is only of significance where the deceased member's estate exceeds the nil-rate band (£325,000 in 2021/22, ignoring any other concessions) and the estate is not transferring between UK domiciled spouses, since IHT is not levied under these circumstances.

Auto-enrolment
Since 2012, all employers in the UK must automatically enrol eligible jobholders into a pension scheme. The auto-enrolment must take place as soon as the jobholder becomes eligible. This is subject to employers being able to choose to use a three-month postponement period before a jobholder is enrolled, but they can only use this postponement period once for each jobholder. The dates by which employers originally had to comply were determined by the size of their payroll and were called "staging dates". Staging dates were between 1 October 2012 and 1 February 2018.

Once an eligible jobholder has been auto-enrolled, they are free to opt out of the scheme. But while they remain an active member, their employer will be required to pay a minimum level of pension contributions on their behalf.

Guidance on auto-enrolment
The legislation on auto-enrolment is very long and complicated. Non-statutory guidance has been published by two main sources:

- The DWP has produced guidance for employers and actuaries about how pension schemes can meet the criteria needed for a scheme to be an auto-enrolment scheme. This guidance has not been updated since 2017; and
- TPR, which is responsible for enforcing compliance with the new employer duties, has published online guidance resources about the reforms. This guidance is comprehensive and includes template letters.

Schemes that may be used for auto-enrolment
Employers may use an existing pension scheme that meets certain criteria set out in legislation or set up a new workplace pension scheme. The Government has also set up a pension scheme for this purpose, called NEST.

Different criteria apply, depending on whether the scheme is a DC scheme, a DB scheme, or a mixture of the two, called a “hybrid” scheme.

To count as an automatic enrolment scheme, a scheme must meet certain basic requirements:

- not contain provisions that are specific barriers to entry in the form of restrictions that:
  - prevent an employer using the scheme to meet its auto-enrolment, opting-in and re-enrolment duties; or
  - requires a new joiner to make a choice or provide information in order to become an active member.

So, for example, a scheme eligibility rule cannot require jobholders to provide evidence of their state of health. Likewise, the prohibition on requiring a jobholder to make a choice before becoming an active member means a jobholder who is automatically enrolled in a DC scheme will need to become a member of a default fund when being auto-enrolled.

- Be either:
  - an occupational scheme established in the UK - the European Economic Area (“EEA”); or
  - a personal pension scheme regulated by a “competent authority” in the EEA. If the scheme is established in an EEA state other than the UK, additional regulatory requirements apply.

DC requirements
If an employer auto-enrols its eligible jobholders in a qualifying scheme operating on a DC basis, it is obliged to pay minimum contributions. For 2021/22, the statutory minimum contribution for an employer is 3% of a jobholder’s qualifying earnings. Overall contributions (including tax relief) must be at least 8% of qualifying earnings. In many cases, employers require jobholders to pay the balance of 5% contributions, though it is possible for the employer to pay the entire 8% if it chooses.

DB requirements
DB scheme criteria are much more complicated than DC. To meet the DB criteria, a final salary scheme must provide that all active members will receive a pension for life, beginning at the scheme retirement age, at an annual rate of at least 1/120 of average qualifying earnings in the three years preceding the end of pensionable service, for each year of pensionable service. The benefits must be revalued in accordance with legislation (see “Workplace Pensions” for further information on revaluation).

CARE requirements
The DB requirements have been modified for CARE schemes, in relation to the revaluation requirements. CARE schemes can revalue benefits:
- at a minimum rate of Limited Price Indexation ("LPI") capped at 2.5% (although it can be capped at a higher rate under the scheme rules); or
- under a discretionary power, on the assumption that benefits will be revalued at least at the minimum rate, provided the revaluation is funded and included in the scheme's SFP; or
- by a combination of the two methods set out above; or
- on a guaranteed basis that is below the minimum rate, but where the funding of the scheme is based on the assumption that accrued benefits will be revalued at or above the minimum rate (and this is provided for in the scheme's SFP).

Hybrid DB/DC schemes.
Hybrid schemes can satisfy either the DB or DC scheme quality requirements. They do not have to satisfy both DB and DC quality tests.

Employee eligibility
To be eligible for auto-enrolment, a worker must qualify as a "jobholder". Jobholders include permanent and temporary employees and agency workers. In addition, the worker must:
- be between age 22 and SPA: and
- must earn at least £10,000 a year (in the 2021/22 tax year).

Jobholders who have been automatically enrolled have a statutory right to opt out of whichever scheme they have joined by giving notice within six weeks of joining.

Jobholders who are not automatically enrolled (for example, because they earn less than the earnings trigger or they opted out or are aged under 22 or over SPa) can opt in by giving their employer notice requiring the employer to arrange for them to join an automatic enrolment scheme. But they can only do this once in a 12-month period. Individuals earning less than the lower end of the qualifying earnings band can ask to join a pension scheme too but will not be entitled to receive any employer contributions.

Employers must provide information to jobholders (and other workers) about auto-enrolment, including details of the contributions that will be paid by and on behalf of them and information about the right to opt out. TPR has produced an online tool that can be used to generate standard-form communications to help with this.

Re-enrolment
Every three years, employers will be required to automatically re-enrol any eligible jobholders who were previously automatically enrolled but who opted out of active membership. Once re-enrolled, the jobholder has the right to opt out within the statutory one month opt-out window as before.

Enforcement of auto-enrolment obligations
TPR polices employer compliance. Its objectives are to:
- establish and maintain a "pro-compliance" culture among employers;
- maximise deterrence for employers considering breaching the new duties;
- detect non-compliance by employers quickly;
- investigate potential breaches of the employer duties fairly and objectively; and
- take enforcement action against non-compliance by applying appropriate civil or criminal sanctions.

The most common areas TPR has found for non-compliance are:
- failure to comply with the auto-enrolment duties and safeguards;
- poor administration relating to auto-enrolment and opting-out processes;
- failure to comply with the requirements for qualifying schemes;
- the provision of incorrect advice to employers about their auto-enrolment duties;
- fraud; and
- unpaid contributions.

Record keeping obligations
Trustees, employers and pension providers are required to keep extensive records, as specified by TPR, to demonstrate compliance with their auto-enrolment obligations.

Compliance
If TPR suspects an employer is breaching its duties, it can require the employer (and others connected with it) to provide information or disclose documents. TPR can also inspect an employer's premises under certain circumstances.
TPR may issue various notices to compel employers, trustees and pension providers to comply with their obligations if they are in default, or to improve on the execution of their obligations and pay contributions which are due but unpaid.

If a breach is not remedied, TPR may order two levels of penalties:
- fixed penalty notice. If an employer or other party fails to comply with one of the above notices, or TPR considers the employer auto-enrolment duties are being breached, it may issue fixed penalty notices. These may provide for flat-rate penalties of £400; or
- escalating penalty notice. For more serious or persistent breaches, there is a system of escalating penalties varying according to employer size. These range from £50 a day for employers with one to four workers to £10,000 a day for those with 500 or more workers.
- Prohibited recruitment penalty notice. Depending on the number of workers, these can range from £1,000 to £5,000.

TPR can also use its power to levy civil penalties and suspend or remove trustees or appoint new trustees.

Certain acts or omissions by an employer can amount to criminal offences. These include a "wilful" failure by an employer to comply with some of the key duties relating to auto-enrolment, re-enrolment, and the jobholder's right to opt in. A person found guilty of one of these offences is liable, on conviction, to imprisonment or a fine or both.

Since 2017, TPR has successfully prosecuted two employers, one of whose directors were jailed. One accountant has also been fined for providing false information to TPR in relation to his employer's auto-enrolment failures.

WORKPLACE PENSION SCHEMES

Types of workplace schemes
Essentially, there are two types of pension provision within the workplace, as summarised in the table below:

Defined Benefit	Defined Contribution
Usually linked to a member's salary as they approach retirement or leaving date.	Usually linked to the size of a member's fund at retirement.
Level of pension benefits known.	Unknown level of benefits until actual retirement.
Investment risk, plus other risks, such as mortality, are borne by the employer(s).	Investment risk is borne entirely by the member.
Unknown costs for the employer, which also pays associated costs such as legal and actuarial fees.	Costs are known, and members generally do not bear any, other than the amounts they contribute to their individual 'pots'.
Funding costs are assessed globally across the membership, resulting in cross-subsidy between member groups and ages.	Each member's pot is kept separate so there is no cross-subsidy.

Defined Benefit (DB)
A DB scheme offers members a promise of a level of benefit that is linked to their earnings at or near retirement or the date they leave pensionable service, if earlier. The promise is set out in the scheme rules, which are usually complicated and therefore explained to members in a shortened booklet setting out the main benefits.

The scheme's investments are pooled and are therefore not allocated to any one member. The benefits promised to individuals within the scheme may vary depending on their personal circumstances, which means that some members' benefits will cost more than others, creating an element of cross-subsidy. For example, married members and those in civil partnerships may be eligible for a death in service spouse's pension but all members, single or married, contribute the same percentage of pay as a contribution. DB schemes are most beneficial to members with long-service. People who leave after a short period of service, with relatively level earnings compared with inflation, are not served so well by this type of scheme.

Accrual
The main feature of a Db scheme is that the amount of pension payable to the member at retirement is not directly affected by factors like adverse investment conditions close to or at retirement. This is because the pension and any other benefits are based on a pre-defined formula that takes into account the member's final salary and their length of qualifying pensionable service.

The normal formula for the calculation of this type of pension benefit is expressed as a fraction of an employee's final pensionable pay for each year of pensionable service. The fractions used can vary from 1/30th to 1/100th of final salary per year, but 1/60th or 1/80th are the most usual.

Salary calculation

The method of calculation of the final pensionable pay varies from scheme to scheme. A common method is to take the basic pay for the last year before retirement, plus the average of any fluctuating earnings (e.g. overtime, bonuses etc.) over the last three years. An alternative is to average the member's actual earnings over the last three years leading up to retirement.

If a member leaves before retirement, their salary is calculated in the same way but based on the member's actual leaving date. Before 6 April 2006, the old HMRC regime set a maximum level of pensionable pay (known as the "earnings cap") for certain members. While this HMRC requirement no longer applies, a scheme's rules may continue to include an earnings cap and this could increase each tax year if the rules provide for the continued operation of the old mandatory earnings cap.

Defined Contribution (DC)

The main feature of a DC scheme (which is not a Cash Balance scheme) for the member is flexibility, especially if the member leaves their employer's scheme early. This is because leavers' benefits are based on the accumulated contributions and investment growth.

However, the level of the benefit depends on investment returns actually achieved and annuity rates at retirement. Unlike DB schemes the employee bears all the investment risk.

It is common for these schemes to be totally invested with insurance companies or in unitised funds. The contributions are allocated to individual "pots" of money - investment funds - that are easily identified as belonging to that member, administered and finally exchanged for individual annuities at the time the benefits are claimed. In theory, it is possible for trust-based DC schemes to offer drawdown, but the majority do not, because of the complexity. If a member wants to access their benefits on a flexible basis, they have to transfer their benefits to a personal pension.

Contract-based DC schemes, provided by insurance companies, normally allow income drawdown, since insurance companies are large enough and have sufficient resources to provide the necessary administration support.

DC contributions and benefits

Subject to the automatic enrolment requirements, the employer's contribution and the employee's (if any) are set in advance and are agreed at the start of the scheme (and at any point thereafter). Contributions to a DC scheme are commonly made on a number of bases:

- a set percentage to be paid by the employer and (if the scheme is contributory) by the member;
- the employer pays a specified rate, determined by the rate the member chooses to pay (e.g. the member pays 3% and the employer pays 5%. If the member increases their contributions to 5%, the employer increases theirs to 7%);
- contributions paid by both the member and the employer, on an age-related basis, so that more contributions are paid as the employee gets closer to retirement age.

Both the employer's and the employee's contributions are invested for the specific benefit of the individual member. A record is kept by the administrators of the contributions paid by and for the member, together with the investment gains and losses and any charges deducted. These are referred to as member "pots" or "accounts". There is no cross-subsidy between members, and this limits the use of the scheme funds to providing benefits for individuals, rather than for particular groups of members.

The retirement benefits are based on the value of the invested contributions (less charges, if any) and on the annuities or other types of benefit that can be secured at retirement by the emerging fund value. There is therefore no guarantee of the level of benefits which are available on retirement.

A tax-free lump sum, of 25% of the fund value, may normally be taken when benefits are brought into payment.

Unlike DB pensions in payment, there are no longer any compulsory increase requirements for DC pensions (including former protected rights – see “DC contracting out” below) which came into payment on or after 6 April 2005. However, pensions which came into payment before that date, and related to pensionable service after 6 April 1997, were required to increase each year by the lesser of the increase in the Retail Prices Index (“RPI”) and 5%. Former protected rights pensions were required to be increased by the lesser of RPI and 3% (in respect of service before 6 April 1997) or 5% (in respect of service after 6 April 1997).

In order to support their decisions, members of all types of pension scheme have access to free and impartial guidance via the phone or face-to-face, from Pension Wise, to help them make the choices that reflect their needs in retirement. The role of Pension Wise is explained in “Role of Government”.

The death benefits from a DC scheme are likely to consist of the value of the member’s accumulated fund, together in some cases with additional life insurance which the scheme or employer may provide. These are typically payable to dependants at the discretion of the trustees (see “Trusteeship” for more information).

Hybrid schemes

It is possible for schemes to be a mixture of DB and DC. Examples of hybrid schemes are:

- DB scheme with a separate DC section;
- DC scheme with a DB underpin – eg:
  - a guarantee that benefits from a DC scheme will be provided at, or close to, a certain level;
  - a DC scheme that provided GMPs (which are salary-related);
  - a DB scheme that provides for benefits from transfers in and additional voluntary contributions on a DC basis.

Cash Balance schemes

A cash balance scheme provides the member with cash balance benefits rather than ordinary DC benefits. The amount available to provide benefits on retirement is not based solely on contributions and other payments made into the scheme by or on behalf of the member. Instead, there is some sort of guarantee attached to the amount that will be available (for example, a fixed amount or percentage of the member’s salary for each year of service, possibly with some revaluation for the period up to retirement). There could also be a guaranteed rate of return on the investment of the payments made into the scheme.

In terms of who bears the investment risk, cash balance schemes fall somewhere between DB schemes (where the sponsoring employer bears all the risk) and DC schemes (where the scheme members bear all the risk). In a cash balance scheme, some of the risk is transferred to the employer because a member is promised an amount at retirement even if the member’s fund value is less than that amount, so the employer must make up the difference.

Cash Balance schemes are not very common.

Career Average Revalued Earnings (CARE) schemes
This type of scheme has become more popular in recent years and average salary is currently the default design for many public service pension schemes.

A CARE scheme can be used by an employer who does not want to move fully away from providing a Db scheme but wants to make costs more predictable than under a DB scheme. Meanwhile, members still benefit from being in a scheme that provides earnings-related benefits.

Because benefits are based on average salaries over the length of their pensionable service, rather than the years immediately preceding retirement, death or leaving service, members whose earnings are higher towards the end of their working life are likely to receive a lower pension from a CARE scheme than a DB scheme. In contrast, members who have a more level earnings history, earn more in the middle years of their career or who move between full-time and part-time work are likely to do better.

Under a CARE scheme, an accrual rate is applied to the member's pensionable earnings to calculate an amount of pension for each year (or, possibly, month) and those pension amounts are added together when the member retires. Each year's pension amount is also revalued for the period between the year (or month) it accrued and the member's NRA, to protect against the effects of inflation.

This revaluation, whilst the member is in pensionable service, is primarily a matter of benefit design, and legislation does not set a minimum rate of revaluation. For example, revaluation could be in line with capped or uncapped increases in the RPI or CPI, the national average earnings index, or by a fixed rate. Or the revaluation rate could be at the discretion of the trustees and/or the employer.

In addition, if an employer wants to use its CARE scheme as a qualifying scheme for automatic enrolment, it must provide for a minimum level of revaluation.

So, the member's final pension will depend on the length of their pensionable service and how many individual pension amounts the member will be entitled to, and by how much each amount will be revalued. Obviously, what the member's earnings are for each year (or month) also has an impact. It is also possible for the accrual rate for one year (or month) to be different from another. For example, a member may start with a 1/80th accrual rate and have the option to pay a higher level of member contribution in return for a 1/60th accrual rate.

If the member leaves pensionable service before NRA, revaluation of the accrued pension must be applied in line with requirements under the Pension Schemes Act 1993.

The difference between a CARE scheme and a DB scheme is that the members share some of the risk under a CARE scheme. The employer still retains most of the risk in relation to the scheme assets continuing to be sufficient to provide the members' benefits (including current and future pensioners). However, the risk for the members lies in the areas of inflation and earnings growth (that is, how any growth in their earnings compares with whatever rate of revaluation is promised by the scheme).

Small Self-Administered Schemes (SSASs)
DC basis, usually for owner-directors of small businesses. Such individuals may wish to retain control over the investment of their contributions, or retain the use of these contributions, as far as possible, to help their own business. SSASs are trust-based occupational pension schemes, in the same way as any other employer-sponsored pension schemes, except that they are not subject to the full range of requirements, as explained below. This is because of the nature of the members, who are the owners and managers of the business sponsoring the scheme. Accordingly, the members are not considered to be as vulnerable as are unconnected employees.

There is potential for conflicts of interest between the use of the SSAS for retirement planning and the use of its assets to support the sponsoring (or associated) business (or for other purposes). Before 6 April 2006, due to the size of the scheme and the nature of its investments, SSASs were monitored closely by HMRC and were subject to additional requirements relating to the control of the format of the trust, the control of the funding and the control of investments. One requirement was that there should be a “pensioneer trustee” who was approved by HMRC and whose main function was to ensure that the scheme was not wound up illegally. See “Trusteeship” for an explanation of what a pensioneer trustee was.

From 6 April 2006, SSASs became subject to the same requirements as any other registered pension scheme in terms of contribution limits and the types of benefit they could provide, and scheme rules had to be adapted to comply with the requirements of the new pensions tax regime.

HMRC no longer requires a pensioneer trustee to be appointed, but many specialised consultancy firms provide independent trustee services specifically for SSASs.

Investment restrictions apply to a SSAS in its capacity as an Investment Regulated Pension Scheme (“IRPS”). An IRPS is a scheme where a member is able (directly or indirectly) to direct or influence the investments the scheme makes. If the scheme invests in things such as art, antiques and jewellery, this will create an unauthorised payments tax charge on the member whose arrangement acquires the asset.
a SSAS is exempt from some of the requirements that apply to other schemes under general pensions legislation, on the basis that it is a “small scheme”. A small scheme is one which has fewer than 12 members, all of whom are trustees of the scheme, and either:

- a) all decisions are made by unanimous agreement by the trustees who are members of the scheme, or
- b) there is an independent trustee involved.

Exemptions include those relating to the member-nominated trustee requirements and the investment regulations relating to investment in the sponsoring employer. It is common for SSASs to make loans to the employer, although this is less common than it used to be, since the requirement was introduced for the loan to be fully secured by a first charge on a property whose value was at least equivalent to the loan. It is still common for SSAS trustees to purchase the sponsoring employer’s trading premises (excluding plant and machinery) from the employer and lease it back, on full commercial terms.

Executive Pension Plans (EPPs)
EPPs share some of the characteristics of a SSAS but do not allow the same range of investment potential and were set up to provide the members with more control over the investment of the scheme contributions rather than as a flexible corporate asset such as with a SSAS. EPPs are normally offered by insurance companies and are fully insured.

Sometimes EPP policies that were part of the investments of a SSAS or an EPP could later become a SSAS.

EPPs are generally set up for highly paid executives or controlling directors. They could be set up to provide benefits for one member only, or a group of members, separate from the rest of a company's workforce.

EPPs are trust-based occupational pension schemes in exactly the same way as any other employer-sponsored pension schemes. Like SSASs, EPPs are exempt from some of the requirements that apply to schemes under general pensions legislation, provided they satisfy the "small scheme" definition. This is because of the nature of the members, who are generally very senior company executives. Accordingly, the members are not considered to be as vulnerable as are unconnected employees.

From 6 April 2006 an EPP is like any other registered pension scheme, although some additional requirements may apply under the new pensions tax regime due to the existence of controlling directors within the scheme membership.

Collective Defined Contribution schemes (CDC)
The concept of CDC provision is that contributions into the scheme are pooled and invested with a view to delivering a target level benefit but, unlike DB, the level is not guaranteed.

Broadly, a particular member's pension would be calculated as follows:
- estimating how much money is needed to provide the target level of benefits to each member; and
- adding up the values for each member to determine the total assets available to provide target benefits to all members.

If the scheme is under (or over) funded, then the level of member benefits can be adjusted to ensure the assets of the collective fund are equal to the liabilities relating to the target incomes.

The Pension Schemes Act 2021 introduced new legislation to establish and operate CDC schemes. The provisions came into force on 1 August 2022. They are referred to in the Pension Schemes Act 2021 as "Collective Money Purchase Benefits" and "Collective Money Purchase Schemes". The schemes will be authorised and supervised by TPR and requirements will be brought in to disclose certain information to members to ensure there is appropriate communication and transparency about how the schemes operate.

Contracting out of the State pension schemes

Integrating State pension with occupational pensions.
Since the 1960s, successive governments have attempted to lay off some of their responsibility for paying the earnings-related part of the pre-2016 State pension onto occupational pension schemes. This was done on a voluntary basis by employers.

DB contracting out
Contracting out was introduced with the implementation of the Graduated Pension Scheme ("GPS"), in 1961, which lasted until 1975. DB pension schemes could contract out of the GPS, but had to provide a pension of equivalent value to that being given up. This was known as an Equivalent Pension Benefit ("EPB"). EPBs are preserved within the scheme unless they were bought back into the State Scheme when the GPS closed.

Contracting out by means of SERPS and S2P

Members of DB schemes could be contracted out of the State Earnings-Related Pension Scheme ("**SERPS**") or the Second State Pension ("**S2P**") between 6 April 1978 and 5 April 2016.

SERPS was replaced by the S2P on 6 April 2002. There are technical differences between SERPS and S2P but, for these purposes, they are treated as being the same benefit.

Employers had the opportunity to contract their employees out of SERPS/S2P, in return for a reduction in employer and employee NICs.

Essentially, an employer's DB scheme provided a minimum level of benefit (with a corresponding reduction to the member's earnings-related part of the State pension for the period that they were contracted out) in exchange for a reduction in the level of NICs payable by the employer and the employee. Between 6 April 1978 and 5 April 1997, a contracted-out salary-related scheme was required to provide a GMP. GMPs ceased to accrue on 5 April 1997 and after that date a contracted-out salary-related scheme was required to satisfy the "reference scheme test". Although GMPs ceased to accrue on 5 April 1997, they still have to be protected against inflation for each tax year until the member reaches GMP age, which is age 60 for women and age 65 for men.

Contracting out through DB schemes ceased on 5 April 2016, when the new State pension regime was introduced. GMPs will continue to exist and will need to be protected against inflation, unless and until they are converted to ordinary scheme benefits by an approved process, known as "GMP conversion".

When workplace pension schemes were equalised following the Barber Case, GMPs themselves were not equalised. Controversy raged for decades as to whether this was correct. In 2011, the DWP announced that contracted-out DB schemes would have to "equalise for the effects of GMPs", which are not only payable from age 60 for women and 65 for men, but also accrue at different rates for men and women. The DWP did not say how equalisation should be done. Various methodologies had been put forward, but not agreed.

The Lloyds Bank court case in 2018 looked at whether there is only one method of equalising, or whether several methods would be acceptable. The court decided that a number of methods could be used by trustees without obtaining the employer's consent. However, the case did not resolve the issue, and further proceedings are taking place. PASA (whose role is explained in "Pensions Industry") formed a cross-industry GMP Equalisation Working Group. The working group has published guidance outlining methods that schemes could use to equalise for the effects of GMPs.

DC Contracting out

Contracting out of SERPS on a DC basis was available from 6 April 1988, through membership of a contracted-out money purchase scheme or via an appropriate personal pension ("**APP**") (and, later, a stakeholder pension). For APPs and stakeholder pensions, NICs were paid at the full rate; the Government paid contracting out NI rebates (called minimum contributions) direct to the pension provider.

The funds resulting from the minimum contributions and minimum payments were called "protected rights", which had to be used to provide benefits on a prescribed basis.

Contracting out on a DC basis was abolished from 6 April 2012. Anyone contracted out at that time was automatically contracted back into the S2P. Protected rights not already in payment on 6 April 2012 also ceased to exist from that date and former protected rights can now be treated the same as any other benefits in the scheme.

Mixed benefit schemes

Between 6 April 1997 and 5 April 2012, it was possible for schemes to contract out on a DB and DC basis at the same time.

Methods of Integrating workplace pension schemes with State pensions

It is common for occupational pension schemes, especially DB schemes, to be "integrated" with the State pension. Integration can be achieved implicitly or explicitly, and in a number of ways:

Implicit integration:

The employer's objective is to provide a total benefit amount at retirement, including the State pension. This would not be explicit in the scheme design so it is normally achieved by providing a benefit in addition to anything provided from the State.

When deciding the level of benefit to be provided, e.g. 1/100th of pensionable salary for each year of pensionable service, the employer recognises that employees will receive their State pension on top of these pension benefits. Such an approach is simpler than an explicit approach, as the pension formula stands alone from the State pension.

Explicit integration:

Here the benefit structure of the scheme includes a "State scheme disregard" or "offset", to take into account the expected build-up of any State pension while the employee is in the scheme, with the scheme providing the remainder.

The Basic State Pension ("BSP") can be taken into account by making a deduction from the final pension or pensionable pay, so that the target benefit, including the BSP is, say, 1/60th or 1/80th of final salary. For example, an employer wants to recognise the BSP, which is about the same as the lower earnings limit ("LEL") (the level of earnings required to qualify for the BSP), so their scheme design is as follows:

Amount of salary	Benefit provided	By whom
Salary up to the LEL	100%	State
Salary above the LEL	1/60th for each year	Employer's scheme

In this example, pensionable salary would be total pensionable salary reduced by the LEL.

Individuals reaching SPA after 5 April 2016 will receive the new single-tier State pension, rather than a combination of the BSP and SERPS/S2P. Integration will still be possible, subject to any changes that may be required to the scheme basis to allow for the change in the State pension.

Increasing GMPs in payment

Pensions attributable to service before 6 April 1997.

DB contracted out schemes are not required to increase GMPs accrued between 6 April 1978 and 5 April 1988. Such schemes are required to increase GMPs accrued between 6 April 1988 and 6 April 1997 by the lesser of the increase in inflation and 3% each year. The Government determines the increase in inflation by means of a statutory order. Since 2010/2011, the government has used CPI as the basis for measuring inflation but, prior to this, RPI was used.

Pensions attributable to service between 6 April 1997 and 5 April 2005.
Subject to the scheme's rules, all of the pension attributable to pensionable service during this period (including the reference scheme benefit) must be increased by LPI (which is the lesser of 5% and the increase in RPI/CPI each year) as a minimum. The government switched from RPI to CPI in 2011 but, depending on the wording of a scheme's pension increase rule, a pension scheme may be required to continue to provide pension increases by reference to RPI rather than CPI.

Pensions attributable to service on or after 6 April 2005.
Pensions attributable to pensionable service on or after 6 April 2005 must be increased by IPI (reduced to the lesser of 2.5% and the increase in RPI/CPI each year), subject to the Scheme's rules.

Financing Workplace Pension Schemes
All active workplace pension schemes receive contributions from employers. Most, but not all, receive contributions from employees who are members. The contributions from both employers and employees are invested to produce income and profits.

In most trust-based schemes, the trustees decide how the contributions are invested. In contract-based schemes, where the contract is in the name of the member, the member has the ability to select investments from a range of funds.

Contributions paid by both employers and employees can be offset against tax.

Employer contributions
Tax relief on employer contributions to a registered pension scheme is given by deducting the contributions paid as an expense against the profits of a trade, profession or investment business. This reduces the amount of an employer's taxable profit.

In the case of a trade or profession, employer contributions will only be deductible as an expense provided they are incurred "wholly and exclusively" for the purposes of the employer's trade or profession.

There are other conditions that have to be met for an employer to receive tax relief on its contributions:
- tax relief can only be given on contributions that have actually been paid; and
- if there is a large increase in the level of employer contributions (£500,000 or more after certain adjustments), tax relief will be spread over a period of between two and four years.

Employer contributions can be:
- ordinary annual contributions, paid regularly to cover the costs of members' future pension benefits (provided the scheme is still open to future accrual). This is only in the cases of DB and CARE schemes. In DC schemes, there is no benefit promise, so the employer contributions simply go into the member's pension pot, to provide investment gains and losses and, depending on the employer promise, to pay costs.
- regular deficit contributions to make up any identified shortfall in the scheme's funding in a DB or CARE scheme.
- additional special contributions, paid as one-off amounts:
  - members, either linked to DB/CARE benefits, or to increase the member's pension pot in a DC scheme;
  - to pay off part of a deficit in a DB or CARE scheme, in addition to the regular deficit contributions;
  - to buy in, or buy out, benefits for a class of members, as part of a de-risking exercise, normally in DB and CARE schemes.

In the late 1980s and early 1990s, following a sustained period of excellent investment performance, several DB schemes were able to allow their sponsoring employer to enjoy a contribution reduction or a contribution holiday. This is where contributions are suspended or reduced temporarily because the value of the liabilities is exceeded by the value of the investments held. Some even allowed their employees a similar contribution holiday.

During periods of poor investment performance in a DB or CARE scheme, the employer may need to increase its contribution rate, or make special one- off contributions to maintain the required funding rate. Sometimes, employers may require members to either pay a higher rate of contributions, or accept reduced benefits, but only for future service.

There is no minimum level of contributions that an employer has to pay to a DC scheme, unless the scheme is used for auto-enrolment.

Sometimes, employers also agree to pay some or all of the expenses of running the scheme, in addition to paying the contributions. Otherwise, the expenses are paid by the trustees of trust-based schemes or deducted from the member pots in contract-based schemes.

Non-contributory schemes
In these, the employer contributes, but the members are not required to. The employer will decide, when setting up the scheme, whether or not members should contribute and, if so, at what rates.

The main advantage for an employer of having no contributions to deduct from employees' pay is simpler administration, which can lead to reduced running costs and simpler systems to operate the scheme.

It also reduces the risk of employees opting out of the scheme and choosing alternative arrangements in preference to the employer's scheme.

Where employers do not require members to pay into the scheme, the members can usually pay contributions voluntarily if they wish ("AVCs" – see "Individual Pension provision").

Employee contributions
The maximum amount of contributions on which a member can have relief in any tax year is potentially the greater of:
- the "basic amount" - currently £3,600; and
- the amount of the individual's relevant UK earnings that are chargeable to income tax for the tax year.

Contributions can be paid by the individual themselves, or by a third party on behalf of the individual member (e.g. by a parent for a child, or by a working spouse/civil partner for a non-working spouse/civil partner).

Pension contributions will normally be based on what the scheme defines as "pensionable" or "contributory" earnings. The actual contribution rate may differ from scheme to scheme and could be based on a:
- percentage of pensionable pay as defined by the scheme rules - the percentage rate can be different for different categories of membership; pensionable pay may exclude certain items of members' remuneration (e.g. bonuses or overtime). This is the most usual method for DB schemes, where the scheme is open and the members still paying contributions;
- stated contribution rate, based on bands of salaries;
- flat rate contribution with no link to salary levels or age.

As explained above, some schemes disregard an element of pay when setting contribution levels, usually related to the State pension, to allow for the fact that members will eventually receive State pension.

Contributions can be taken from gross pay using the "net pay arrangement", which means that the contributions are deducted from gross pay before tax is applied to the resulting reduced earnings. Alternatively, contributions can be taken from pay after tax using the "relief at source" method, meaning contributions will be paid after deducting the basic rate of tax, currently 20%. This tax is then reclaimed from HMRC by the scheme administrator and added to the pension fund.

No tax relief is given on pension contributions paid by a person who is over age 75.

Annual Allowance

There is an annual limit on the total of employee and employer pension contributions (called the "Annual Allowance") which is currently £40,000, but which may be reduced to £4,000 if the employee has already accessed a pension pot on a flexible basis. Above these annual amounts, the employee will not receive tax relief, and will incur a tax charge, called "the Annual Allowance charge", at his or her marginal rate of income tax.

The AA is also reduced for high earners, if certain thresholds are exceeded. This is called "tapered Annual Allowance".

Lifetime Allowance

- There is an overall lifetime limit on the value of pension benefits which can receive tax relief, which is a fund value of £1,073,100 for the tax year 2021/22. This is called the "Lifetime Allowance". In the case of a DB scheme, this value is normally calculated by multiplying the annual pension paid, using a rate of 20:1. Benefits are tested against the LTA when they come into payment (and at age 75 for any benefits not taken at that point). It has been possible to protect LTAs, as they have become smaller, on an individual basis, via
- primary protection;
- enhanced protection;
- fixed protection;
- individual protection 2014;
- fixed protection 2014;
- fixed protection 2016; and
- individual protection 2016.

The rules governing these types of protection are very complicated.

Actuarial valuations

Purpose

DB and CARE schemes promise their members a certain level of benefit, related either to earnings close to retirement or leaving pensionable service, or earnings averaged over the period they were members of the pension scheme. The scheme's funding level needs to be reviewed and the amounts of contributions paid by employers (and, sometimes, members) re-evaluated from time to time, with a view to ensuring that the scheme has sufficient funds to pay the promised benefits. This is done by means of periodic "actuarial valuations".

Actuarial valuations have several interlinked objectives:
- establish the current funding level for accrued benefits;
- establish the level of contributions required from the employer to achieve and maintain the desired funding level;
- establish a schedule of contributions;
- satisfy certain statutory requirements.

Scheme Specific Funding

The Scheme Specific Funding regime was introduced by the Pensions Act 2004. It requires schemes to adopt the "Statutory Funding Objective". This means that they must have "sufficient and appropriateb assets" to cover their "Technical Provisions". A scheme's Technical Provisions means the amount required, on an actuarial calculation, to make provision for the scheme's liabilities.

The following documents must be produced as part of the valuation:
- Statement of Funding Principles - a statement setting out the trustees' policy for ensuring that the Statutory Funding Objective is met; it should include the valuation method and assumptions and the trustees' policy on how any deficit will be made up;
- Actuarial Certificate – a certificate signed by the Scheme Actuary certifying that the calculation of the scheme's Technical Provisions has been made in accordance with the regulations;
- Schedule of Contributions – a statement showing the rates of contribution to be paid to the scheme by the employer and the active members, including any restrictions on when payments must be made; if the contributions are not paid by the due dates, this is a breach reportable to TPR and the employer could be fined for such a breach; and
- Recovery Plan – if the Statutory Funding Objective is not met then a Recovery Plan must be prepared detailing the steps to be taken to meet the Statutory funding objective and the period within which that is to be achieved.

Employer Covenant
- The approach of the trustees to funding should be proportionate and balanced; the trustees should be prepared to address the implications of failing to put in place an adequate funding solution.

Scheme Funding Code

TPR published Scheme Funding Code 03 in 2006 and has updated it periodically. The current version covers valuation effective dates from 29 July 2014. The key points of the 2014 Code are:
- the trustees should work collaboratively with the employer to agree the SFP, schedule of contributions and, if necessary, a recovery plan;
- an integrated approach should be adopted by the trustees to manage risks in relation to employer covenant, investment and funding;
- the approach of the trustees to funding should be proportionate and balanced; the trustees should be prepared to address the implications of failing to put in place an adequate funding solution.

The 2014 Code changed the previous wording in relation to deficits from "trustees should aim for any shortfall to be eliminated as quickly as the employer can reasonably afford" to requiring the trustees to "consider the risks to the scheme and the impact on the employer". What is possible and reasonable will depend on the trustees' assessment of the employer's covenant.

On 3 March 2020, TPR launched the first stage of a consultation on a revised DB scheme funding Code of Practice, on measures introduced by what was then the Pension Schemes Bill 2019-21 (which became the Pension Schemes Act 2021), as follows:

- introducing a statutory requirement for trustees to implement a funding and investment strategy ("long-term objective", or "LTO") to ensure that pensions and other benefits under the scheme can be provided over the long term;
- introducing a requirement for technical provisions to be calculated in a way that is consistent with the LTO;
- requiring trustees to prepare and submit to TPR a written statement of strategy setting out the scheme's LTO and other matters;
- introducing a requirement for all schemes required to carry out actuarial valuations, not just those with a recovery plan, to send the actuarial valuation to TPR; and
- amending the Pensions Act 2004, to allow TPR to direct the trustees to revise their funding and investment strategy if not compliant.

The original deadline for responses to the consultation was 2 June 2020. Responding to difficulties presented by the Covid-19 pandemic, TPR extended the deadline to 2 September 2020. TPR opened a consultation on the draft funding code in December 2022. The consultation closed in March 2023.

How actuarial valuations are carried out.

The Scheme Actuary reviews the data for all the members of the scheme, makes certain assumptions about increases to future earnings (if the scheme is still actively accruing benefits) and future investment earnings and costs, as affected by inflation and mortality rates. This review results in an assessment of the scheme's funding level. The Scheme Actuary then produces a recommended contribution figure for the employer to commit to paying. The actual rate the employer will pay may be subject to negotiation with the trustees, within a range of parameters. Sometimes, the resulting figure may lead the employer to decide to stop future accrual of benefits, reduce future benefits (but not benefits already earned) or require the members to pay higher contributions in the future.

Once the employer contribution rate has been agreed and, if the scheme rules are silent, a decision taken as to whether the employer will pay some or all of the running costs, a Schedule of Contributions will be produced. This, together with a suite of other documents, must be sent to TPR and a Summary Funding Statement must be sent to the members within a certain timescale.

The Scheme Actuary will look, in detail, at a number of assumptions, as set out below.

Demographic assumptions

These assumptions include rates of:

- withdrawal from service (if the scheme is actively accruing benefits);
- death in service;
- early retirement;
- salary progression;
- mortality in retirement.

In a scheme of any size, demographic assumptions are likely to reflect the experience of the scheme concerned. However, note will also be taken of underlying trends, for example the trend for people to live longer, which is making pensions more expensive, as they will be paid out for longer. The recent COVID pandemic has added to the uncertainty in relation to life expectancy.

In many medium to large schemes the Scheme actuary will assume a certain number of members are married/in civil partnerships, and assume the age of the spouse/civil partner, rather than take the actual number of married members/civil partnerships and the actual age of the spouse or civil partner.

Economic assumptions
Economic assumptions will have a greater impact on the valuation results than demographic assumptions. They will reflect long term averages and can be very different from current rates. This is because pension liabilities have a very long timeframe and assumptions based on a snapshot in time will not necessarily be representative of expectations over the long term. These assumptions will include items such as:
- CPI and RPI
- general salary inflation
- pension increases
- expected return on investments

Calculating the recommended employer contribution
Using the chosen funding method and the data of existing members, the Scheme Actuary will calculate the present value of the scheme's existing liabilities. These will be compared with the current value of the assets of the scheme to give a funding level. For example:

Value of liabilities		**Value of assets**	
Active members	£3m	Total	£5m
Preserved members	£1m	Funding level ((£5m / £6m) x 100)	83.33%
Pensioners	£2m		
Total	£6m		

The scheme is 83.33% funded (i.e. the assets are only 83.33% of the liabilities) and is said to be "in deficit".

The next step will be to estimate the cost of the accrual of benefit for active members. This is usually done by estimating the cost for the next year's benefit but allowing for expected salary increases up to retirement. Generally, this will be expressed (net of member contributions) as a percentage of pensionable salaries.

For example, this might be 8.6%.

The final calculation estimates the increase in the next year's cost to take account of the deficit (there might be a reduction if the scheme were in surplus, ie, the assets were greater than the liabilities). The addition to eliminate the deficit over a suitable period would be calculated and could be say 5% (alternatively this could be expressed as a fixed monetary amount to be paid each year).

In this example, therefore, the actuary would recommend an employer contribution rate of 13.6%, and this would be payable until the next actuarial valuation.

Occupational DC schemes
Although such schemes are not required to carry out actuarial valuations, and there is no requirement for them to appoint a Scheme Actuary, they are still required to have a payment schedule, setting out the rates and due dates of contributions from the active members and the employers participating in the DC scheme. The employer can be fined by TPR for not paying employer and/or member contributions by the due dates in the payment schedule.

In DC schemes, where the employer targets a particular level of pension at retirement without guaranteeing the outcome, an actuary may be asked to recommend an employer's contribution rate.

Discrimination in workplace pension schemes

All forms of discrimination are prohibited in workplace pension schemes (subject to certain statutory allowances). Discrimination occurs (broadly speaking) where somebody with a “protected characteristic” is treated less favourably than they would have been, but for that protected characteristic.

Protected characteristics are set out in the Equality act 2010 and are:

- age;
- disability;
- gender reassignment;
- marriage and civil partnership;
- pregnancy and maternity;
- race;
- religion or belief;
- sex; and
- sexual orientation.

The Equality Act 2010 imposes an overriding non-discrimination rule on all occupational pension schemes, whether or not such a rule is included in the scheme. This rule requires trustees to refrain from doing any act which is directly or indirectly discriminatory.

The two main types of discrimination affecting pension schemes are age discrimination and sex discrimination.

Sex discrimination

The “Barber Case” in 1990, concerned the equal treatment of men and women. It resulted in schemes having to comply with equalisation requirements. Prior to this date, schemes could, and frequently did, operate different retirement ages - 65 for men and 60 for women. Women could - and often did - have to work for longer and be older, before joining a scheme. Part-time workers (then, mainly women) were usually unable to join at all.

The effective date for applying the Barber requirements is the date of the judgment, 17th May 1990. With effect from that date, NRA for schemes must be the same for men and women. The choices were:

- adopt the female NRA of 60 for men for pensionable service on and after 17 May 1990 (equalise ‘upwards’). This was found to be prohibitively expensive for the majority of DB schemes;
- adopt the male NRA of 65 for women for pensionable service on and after 17 May 1990 (equalise ‘downwards’). This is the most common method; or
- adopt a retirement age between the two, say 63.

A lot of schemes did not equalise or carried out the process incorrectly. It is not unusual for some schemes to have up to three different NRAs for benefit calculation purposes:

- 65 for men and 60 for women for pensionable service up to 16 May 1990; then
- 60 for men and women for pensionable service from 17 May 1990 until effective date of equalisation; then
- 65 for men and women from effective date of equalisation onwards.

If a scheme did not effectively equalise, NRA remained at 60 for both men and women.

NRA was not as important for DC schemes, which have no benefit calculation date. However, insurance companies used to impose penalties where members left before NRA; this would have affected men more than women when pension ages were 60/65.

All pension schemes are now deemed to include a rule that there will be equal access for men and women (including those working part time) to the scheme and that benefits will be calculated on an equal basis and with equal terms and conditions.

Age discrimination
Broadly speaking, all members have to be treated equally, regardless of their age. This applies to younger members as well as older members. However, certain practices that are, on the face of it, discriminatory, are permitted by law. Examples of this are:
- waiting periods: for example, employees can be required to be employed for a minimum period of time before they can be admitted to the scheme, or start accruing, or are entitled to a particular scheme benefit;
- admission to schemes: for example, employers can restrict admission to a pension scheme by reference to:
  - a minimum or maximum age; and/or
  - a minimum level of pensionable pay where the minimum is based on the value of State pension provision.
- pension increases: different pension increases are allowed in certain circumstances, for example, pensioners over age 55 can receive larger pension increases than pensioners below that age.

Age discrimination can be lawful if there is an “objective justification” for the provision.

Benefits paid from workplace pension schemes

Retirement

Pension paid from the scheme
On retirement, benefits are paid in the form of a tax-free lump sum, referred to as a ‘pension commencement lump sum’ (see below) and a stream of income, which is taxed as earned income. Normally, the tax-free lump sum may be a maximum of 25% of the value of the fund. Members can choose to take no lump sum, or a lower lump sum than they are entitled to take and have a higher resulting income. Larger DB schemes usually provide a pension direct from scheme funds.

Alternatively, a pension can be purchased from an insurance company – commonly known as an annuity.

Annuities
An annuity is a pension purchased from an insurance company, almost always payable for the life of the person for whom it is bought. The insurance company will, using probabilities of life expectancy, purchase bonds of an appropriate term, and other assets, to provide the income it anticipates being obliged to pay.

An annuity may be bought by the trustees of a DB scheme - often a fairly small scheme - for a new pensioner or deferred member (a “lifetime annuity”), or sometimes for all members by trustees of a scheme which is being wound up.

In a DC scheme, individual members may purchase a lifetime annuity when they take their benefits. Annuities come in many forms. They can be:
- single life, for the life of the annuitant only;
- joint life, for the lives of the annuitant and a spouse (or dependant);
- reversionary only, for a spouse, to commence on the pensioner’s death.

Annuities may also be level or increasing at chosen rates (a set annual percentage, or by a link to an inflation index). The greater the rate of increase, the greater will be the cost of the annuity.

Annuities can come with or without a guarantee. A guarantee will relate either to
- the number of payments that must be made regardless of whether the annuitant survives, or
- the amount of capital that was paid, less the pension payments already made.

A guarantee may be for up to ten years' payments; the shorter the guarantee, the higher the starting annuity.

Some annuities may provide a higher level of income than a standard annuity. These include enhanced annuities ("impaired life annuities") for people with a reduced life expectancy through being a smoker or overweight, or those suffering from ill health.

Investment-linked annuities may provide a higher level of income if investment markets are performing well but otherwise could provide less than annuities which guarantee the level of income payable.

Normal retirement
Prior to 6 April 2006, it was necessary for a member to leave employment before taking the pension from that employment. Prior to 6 April 2006 an occupational scheme also had to specify a normal retirement age when applying for approval. The concept of "retirement" has now disappeared from HMRC's pension rules. Subject to the rules of the individual schemes, it is possible for members to trigger benefits whilst in the occupation relating to their scheme, and to take their benefits in tranches, either regularly or as and when they wish, depending on the scheme's rules.

With effect from 6 April 2006 the old HMRC NRA was replaced by the Normal Minimum Pension Age ("**NMPA**"), which started as age 50 but has been age 55 (with certain exceptions) from 6 April 2010. NMPA will increase to age 57 with effect from 6 April 2028.

The DRA of 65 has also disappeared from employment legislation. This was the age at which employers could compulsorily retire employees. However, pension schemes are still able to set their own NRA for benefit calculation purposes. It has normally been 65, at least since the barber Case (covered above).

Some schemes have members with special occupations that are considered to be dangerous or more demanding than normal occupations and customarily retire at earlier ages. Examples of special occupations are:
- professional sportsmen and women
- nurses, police officers and firefighters
- dancers and newscasters

The NMPA still applies for such members but some members may have an earlier NRA - if they had one before 6 April 2006 - and this can be protected under the transitional provisions which apply within the current pensions tax regime.

If the scheme is integrated with the State scheme, the scheme may provide a supplementary temporary pension ("bridging pension") for the period between NRA and SPA when the State pension becomes payable. The objective is to provide the retired member with a level income both before and after attainment of SPA.

Where a DB scheme specifies an NRA, this is mainly for funding purposes. Existing rules that allow benefits to be drawn before or after NRA continue to operate. These options are normally subject to the consent of the trustees and/or the employer (because there can be cost implications).

Retirement from DC schemes
At the point of retirement, at whatever age after NMPA (unless in ill health, when pension benefits can be accessed at any age), the member can access the value of their individual investment fund (their “pot”). If this is used to buy an annuity, the annuity rates available for an early retiree will reflect the longer payment term, i.e. a reduced annuity is offered as a result of the expected longer period of payment.

Younger members retiring on the grounds of ill health may find that their pots do not support the purchase of a standard annuity. However, larger “impaired life” annuities may be provided if the person retiring has a reduced life expectancy, or the employer could decide to enhance the pension by making an additional contribution within permitted limits.

There are normally no special measures for early or late retirement in DC schemes. The earlier the pension pot is accessed, the smaller the resulting annuity/drawdown will be. The converse will apply for late retirement.

Early retirement
Early retirement is not allowed before NMPA unless this is on grounds of ill health, where certain medical evidence is required.

Early retirement from DB schemes
DB schemes in the private sector usually offer an early retirement pension based on the accrued pensionable service and actual final salary at the date of retirement or earlier leaving (if the member left pensionable service before retirement and is retiring from deferred status). This is provided the member has reached NMPA. An early retirement reduction factor is applied to reduce the accrued pension to take account of the longer payment term from an earlier age. If the early retirement from pensionable service is because of redundancy, ill health, or at the request of the employer, the early reduction factor may be waived, depending on the scheme’s rules.

Early retirement can have a financial impact on a scheme. It is common for scheme rules to contain a proviso that the consent of the trustees and/or employer must be given to requests for early retirement. It is also common for the early retirement reduction factors to be set so that they are financially neutral, as between the member and the scheme.

The reduction factor increases with the length of time between actual retirement and the normal retirement date (i.e. the younger the retiree, the larger the reduction), since the pension will be paid for a longer period, the earlier the member retires. Age criteria in actuarial calculations (e.g. actuarial adjustments to take account of early and late retirement) are permissible exceptions under

The Equality Act (Age Exceptions for Pension Schemes) Order 2010.
If the early retirement from pensionable service is a result of ill health, there is normally a provision for the scheme to pay out an immediate pension regardless of age, sometimes without applying a reduction factor, and sometimes also taking into account pensionable service that would have been completed to NRA, but for the ill health. Deferred pensioners retiring on ill health grounds usually receive just their revalued deferred pension, which may or may not be reduced for early retirement.

See below for more about payment of a serious ill health lump sum.

Late retirement from DB schemes

If a member of a DB scheme, which is still accruing benefits, works past their NRD, there are several ways in which benefits can be enhanced, including:

- the additional pensionable service worked counting towards accrued benefit; or
- increasing the actual pension calculated at NRA by a late retirement factor to take into account the deferment period and the shorter period of payment; or
- The pension is calculated at NRA and increased in line with prices, or some other acceptable index, until actual retirement.

To comply with age equality law, members normally need to be given the option of continuing to contribute and accrue benefits, instead of automatically ceasing to accrue at NRA with the pension being increased in line with actuarial factors until being eventually drawn. If a member makes this choice, the employer will have to continue to pay their contributions on behalf of a member.

Where a deferred member decides not to draw their deferred pension until after scheme NRA, the pension will normally be increased by a late retirement factor, or a prices index.

Early leavers from DB and DC schemes

A scheme member who leaves pensionable service after 3 months, and with less than two years pensionable service, must be told that they can have their own contributions refunded (less tax) or a transfer value to another registered pension scheme.

Members who leave with more than two years pensionable service have their pension rights preserved in the scheme until they reach the scheme's NRA or die. As an alternative, they can transfer the benefit to another registered pension scheme or, if they are over NMPA, have the pension paid early.

The deferred pension from a DB scheme is calculated on pensionable salary, as defined in the scheme rules, at the date of leaving and pensionable service accrued to the date of leaving.

In a DC scheme, the member's "pot" remains with the scheme, accumulating (or depreciating) in line with the investment strategy of the member's selected fund.

Non-GMP pension increases and revaluation

Before retirement

Pension benefits from DB formerly contracted-out schemes usually consist of two components – GMP and non-GMP. Each component must be revalued before they come into payment. GMP revaluation is set out above, under "Contracting Out".

For the component of pension in excess of GMP, revaluation is required by law. The revaluation is the minimum required – scheme rules can require higher revaluation. The minimum revaluation is set out each year in Orders from the Secretary of State.

Different rates of revaluation apply, depending on when the member stopped accruing pensionable service and became a deferred pensioner:

- there is no statutory requirement to revalue non-GMP benefits where the leaving date was before 1 January 1986;
- where the leaving date was between 1 January 1986 and 31 December 1990:
  - non-GMP benefits accrued prior to 1 January 1985 do not have to be revalued, and
  - non-GMP benefits earned after 1 January 1985 are increased in line with the Secretary of State's Orders.
- where the leaving date is on or after 1 January 1991, all of the pension in excess of GMP must be revalued in line with Secretary of State Orders.

Until 5 April 2008, the statutory minimum rate of revaluation was RPI with a maximum increase of 5% per annum. Benefits accrued after 6 April 2009 are subject to a cap of 2.5% per annum.
For revaluation on and after 6 April 2011, the measure of inflation used changed from RPI to CPI.

CARE schemes, can, if the trustees consider it appropriate, revalue a former active member's pension accrual over the period of deferment in any way they would have been revalued by the scheme if the member had remained in pensionable service.

After retirement

- Benefits earned in excess of GMP, for pensionable service prior to 6 April 1997, do not have to be increased during payment.
- Benefits in excess of GMP earned for pensionable service between 6 April 1997 and 5 April 2005 must increase by LPI capped at 5%.
- Benefits in excess of GMP earned on and after 6 April 2005 must increase by a minimum of LPI capped at 2.5%.

For statutory increases on and after 6 April 2011, the measure of inflation used changed from RPI to CPI.

Sometimes, scheme rules specify a higher level of protection than the minimum, for pension in payment. If this is the case, the higher level applies, unless and until the employer negotiates a lower level for future increases. The most common situation is where the scheme rules specify that the higher level of increase afforded by RPI must be used, rather than the lower level of CPI, or the rules include a fixed percentage increase, such as 5%. Some scheme rules provide for the whole of the pension in excess of GMP to be revalued, not just that applicable to pensionable service from 6 April 1997.

Increasing pensions attributable to Additional Voluntary Contributions (AVCs)
If part of the member's pension is attributable to contributions paid voluntarily by a member, over and above their contractual rate, there is no requirement to increase that tranche.

Spouse's and dependants' pensions from DB schemes
Spouse's and dependants' pensions, where the member dies whilst in pensionable employment, after leaving or as a pensioner are usually a fraction of a member's expected benefit at retirement. The most popular fraction is one half.

Subject to the scheme's rules, a spouse's or dependant's pension may be payable, if the recipient is the member's spouse or dependant at the date of death, or the member's child (subject to certain qualifying conditions being met). If neither applies, a pension can only be paid to a person who was financially dependent (or financially interdependent) on the member, or dependent on the member because of a physical or mental impairment, at date of death.

Db schemes which were contracted out prior to 6 April 2016 have to provide a minimum level of spouse's pension. For schemes contracted out before 6 April 1997, 50% of the member's entire GMP is payable to the member's widow, while 50% of the member's GMP accrued from 6 April 1988 is payable to the member's widower/civil partner. Schemes contracted out from 6 April 1997 had to provide a 50% spouse's pension.

Often, in public sector schemes, the pension payments cease if the widowed spouse remarries. Private schemes commonly continue to provide the spouse's pension in this situation.

Some schemes do not automatically provide spouse or dependants' pensions on the death of a member after retirement. In these cases, the members can choose to have a lower level of retirement pension for themselves in order to build in protection for their dependants by selecting a dependant's option. This is sometimes referred to as "allocation".

Pensions for civil partners and same-sex spouses from DB schemes
Originally, individual scheme rules determined whether or not a surviving same-sex partner would be entitled to receive benefits. However, this changed due to the Civil Partnership Act 2004 and the Marriage (Same Sex Couples) Act 2013.

For the purposes of State benefits, broadly speaking civil partners are treated the same as spouses, and same-sex spouses the same as civil partners.

For private occupational pension schemes, civil partners and same-sex spouses must be treated the same as opposite-sex spouses and opposite sex civil partners. Originally, this was in relation to non-contracted-out benefits accrued from 5 December 2005 – although benefits in relation to pensionable service before that date could also be provided if the scheme rules allowed. On 12 July 2017, the Supreme Court handed down its judgment in the case of Walker v Innospec Limited and unanimously declared that civil partners and same-sex spouses must receive the same benefits as opposite-sex spouses (i.e. any spouse's pension should be calculated by reference to all of the member's pensionable service, not just pensionable service completed after 5 December 2005).

Contracted-out benefits must be provided on the same basis as for widowers in relation to GMPs accrued from 6 April 1988 and a 50% pension must be provided to the civil partner/same-sex spouse in relation to contracted-out service from 6 April 1997.

Spouses' and dependants' pensions from DC schemes.
The deceased member's "pot" can be used to pay either a stream of income from the scheme, or to buy an annuity from an insurance company.

Lump sum payments

Serious ill health lump sum
Subject to the scheme's rules, a member can take their benefits from either DB or DC schemes as a lump sum instead of a pension, if they are suffering from serious ill health. Such a lump sum is called a "serious ill health lump sum" and can be paid regardless of the member's age. For a member to be classed as suffering from serious ill health there must be evidence from a registered medical practitioner that the member is expected to live for less than one year.

The lump sum is normally tax-free if paid to a member under the age of 75 but if it is paid to a member who has already reached age 75, the lump sum is taxable at the member's marginal rate of income tax.

Trivial commutation and stranded pots
Scheme rules permitting, members who are at, or over, NMPA, may take all their benefits as a one-off cash sum (not exceeding £30,000) instead of receiving a small pension from the scheme. This is called trivial commutation, although different requirements apply for trivial commutation lump sums and other small lump sums.

Trivial commutation lump sums ("TCLS")
For payments made on or after 16 September 2016, TCLS can only be paid in respect of:
- defined benefits arrangements, or
- "in-payment money-purchase in-house scheme pensions", which are scheme pensions payable by the scheme administrator, to which the member has become entitled under a money purchase arrangement.

The scheme determines the capital value of a DB pension benefit being commuted, although HMRC has set out complicated rules for valuing the pension benefits, depending on whether the member has already accessed their benefits (crystallised) or not (uncrystallised) or a combination of both.

A TCLS can only be paid on or after the member's NMPA unless they are able to take benefits as authorised payments before that age because they either meet the ill health condition or have a protected pension age. The individual has a one-off 12-month period to commute trivial funds across all their schemes.

Small lump sums
Small lump sum payments can be made where there are "stranded pots". This is where payments are made into a scheme after a member has taken all of their benefits or transferred out. For example, late payments from insurance companies, or from the Financial Services Compensation Scheme.

Regulations set out the conditions that have to be met for small pension lump sums to be paid and remain authorised payments (i.e. not attract tax penalties). The conditions vary according to which way the member took their benefits, but the common conditions are:
- the minimum age is 55 unless the member was in ill health or had a protected pension age;
- at least part of the member's Lifetime Allowance was available at the time the member took the original benefit;
- the small lump sum payment must be made within 6 months of the "relevant accretion" (i.e. the additional payment);
- the maximum payment that can be made is now £10,000;
- the payment must not exceed the value of the relevant accretion.

Uncrystallised funds pension lump sum (UFPLS)
This lump sum can be paid from "uncrystallised funds" held in a money purchase arrangement for members, who must be at or over NMPA. This gives members "flexible access" to their benefits. Uncrystallised funds are funds held in respect of the member which have not, as yet, been used to provide that member with a benefit under the scheme (so have not crystallised for Lifetime Allowance purposes).

Where the member has not reached age 75, 25% of the UFPLS is not liable to tax, and the remaining 75% is taxed as pension income in the same way as a pension paid under a registered pension scheme.

Where the member has reached age 75, the taxation is more complicated, depending on whether the member has previously accessed certain types of benefits and depending on how much (if any) of the member's Lifetime Allowance was taken up by those pension benefits.

Pension commencement lump sum (PCLS)
A PCLS can only be paid provided the member has become 'actually entitled' to a relevant pension benefit under the registered pension scheme making the lump sum payment. The maximum amount payable will be capped by reference to the value of that arising pension entitlement. "Relevant pension" includes income withdrawal, a lifetime annuity or a scheme pension. In relation to a scheme pension (which is a lifetime pension paid from a registered pension scheme or a lifetime annuity), a lump sum can only be treated for tax purposes as a PClS in connection with a relevant pension paid from the same pension scheme, not a deferred pension.

Winding up lump sum (WULS)
If an occupational pension scheme is winding up (perhaps because the employer has gone out of business), certain benefits (including pensions in payment) can be paid as lump sums. The maximum amount that can be treated as a WULS is £18,000. Where specifically identifiable contingent beneficiary's benefits/rights exist, these must be extinguished along with the member's own entitlement to benefits and paid to the member as part of the WULS payment.

The £18,000 limit applies on a scheme-by-scheme basis. Benefits held in other schemes, either crystallised or still accruing, do not need to be aggregated with the payment being made from the scheme that is winding up.

Under a DC arrangement, the lump sum will be the value of the sums and assets held in that arrangement.

Under a DB arrangement, it is for the scheme to attribute a capital value to the pension benefit entitlement being commuted.

If the member has not previously drawn (or become entitled to) any other benefits under the registered pension scheme before the winding-up lump sum is paid, 75% of the lump sum paid is treated as taxable pension income of the member for the tax year the payment is made, accountable through PAYE. Where the only rights being commuted represent a pension in payment, all of the WULS is treated as taxable pension income of the member for the tax year the lump sum payment is made.
This taxable income is accountable through PAYE.

Scheme specific protection for pre-2006 lump sums.
Before 6 April 2006 some individuals had the right to be paid a tax-free lump sum of more than 25% of their total benefit under a pension scheme. Scheme-specific lump sum protection is the name given to the form of protection that allows such individuals to be paid a PCLS that is more than 25% of the value of their total benefits coming into payment from the registered pension scheme. The scheme rules have to permit lump sum payments in excess of 25%.

Administration and Governance of pension schemes
Underpinning all pension scheme administration is the collection and processing of data, whether it be financial, general or the personal data of the members and other beneficiaries. The majority of complaints relating to pension schemes, by members, are in relation to personal data processing, whether delays in, or maladministration relating to, collection and processing of personal data, resulting in delayed and/or incorrect benefits being paid.

GDPR and The Data Protection Act 2018
All personal data held about a person, whether it is in paper files or on a computer, is subject to the Data Protection Act 2018 ("**DPA 2018**"). The Act gives those about whom data is held a number of rights in connection with that data.

The General Data Protection Regulation ("**GDPR**") was approved by the EU Parliament in April 2016, with an implementation date of 25 May 2018.

Because the GDPR is an EU regulation rather than a directive, and is directly binding and applicable, it did not require any enabling legislation to bring it into force in the UK. However, partly in anticipation of the UK leaving the EU at the end of the transitional period on 31 December 2020, DPA 2018 was passed, containing equivalent regulations and protections. The DPA 2018 received Royal Assent on 23 May 2018 just before the GDPR's implementation date. The main provisions of the Act, like the GDPR, apply from 25 May 2018. The DPA 2018 brings the GDPR's provisions directly into UK legislation (subject to certain amendments). The DPA 2018 and GDPR cover similar ground, and the DPA 2018 supplements the GDPR in some areas unrelated to pensions.

The ICO has provided guidance on the new data protection requirements, although these are not particularly aimed at pension schemes.

The key changes introduced by GDPR and, hence DPA 2018, include:

- stronger rights for data subjects, including the right to have data erased ("the right to be forgotten") and a new right to data portability;
- more detailed conditions for valid consent to the processing of personal data, however held (electronically or on paper), making the use of the consent ground as a means for processing data more difficult;
- separate duties for data processors, who may also be fined for breaches and liable for damages;
- new accountability obligations for data controllers, requiring them to show how they comply with the GDPR;
- a mandatory requirement to report personal data breaches that are likely to result in a risk to the rights and freedoms of data subjects to the ICO and also, in certain circumstances, to data subjects;
- significantly increased penalties for data breaches, up to a maximum of EUR 20 million or 4% of an undertaking's annual worldwide turnover.

There were originally eight Data Protection Principles in the Data Protection Act 1998. There are seven principles in GDPR and DPA 2018, as follows:

- **Lawfulness, fairness and transparency.** Personal data must be processed lawfully, fairly and in a transparent manner in relation to the data subject;
- **Purpose limitation.** Personal data must be collected for specified, explicit and legitimate purposes and not further processed in a manner that is incompatible with those purposes;
- **Data minimisation**. Personal data must be adequate, relevant and limited to what is necessary in relation to the purposes for which it is processed;
- **Accuracy**. Personal data must be accurate and, where necessary, kept up-to-date. Every reasonable step must be taken to ensure that personal data that is inaccurate, having regard to the purposes for which it is processed, is erased or rectified without delay;
- **Storage limitation**. Personal data must be kept in a form which permits identification of data subjects for no longer than is necessary for the purposes for which the personal data is processed;
- **Integrity and confidentiality**. Personal data must be processed in a manner that, through use of appropriate technical or organisational measures, ensures appropriate security, including protection against unauthorised or unlawful processing, accidental loss, destruction or damage.

Accountability. The Data Controller must be responsible for, and be able to demonstrate compliance with, the preceding six principles.

Data controller
The data controller is the person who (alone or jointly) ultimately determines the purpose and manner in which any personal data is to be processed e.g. the trustees of a pension scheme, and some service providers. Controllers are required under the GDPR and DPA 2018 to undertake due diligence and include key provisions in agreements with processors. Some of the considerations for trustees are as follows:
- properly implemented data security policy;
- nominated individual with overall responsibility for data security;
- technical security applied to data held electronically e.g. encryption, password protection, rules about downloading to mobile devices;
- physical security to data in paper form and electronic devices on which data is stored;
- vetting and training those who have access to personal data;
- access limited to that which is necessary;
- secure disposal of hard copy data;
- secure deletion of electronic data;
- appropriate due diligence before using service providers; and
- contracts with service providers.

Data processor
The data processor can be any person who processes the data on behalf of a data controller e.g. scheme administrators. Data processors used to have no direct obligations under the Data Protection Act 1998, but under the GDPR and DPA 2018, data processors are subject to direct duties and may be fined for breaches and liable for damages.

Scheme administrators and others who process data on the trustees' behalf are data processors.

Data subject
A data subject is any individual person who can be identified, directly or indirectly, via an identifier such as a name, an ID number, location data, or via factors specific to the person's physical, physiological, genetic, mental, economic, cultural or social identity. In other words, a data subject is an end user whose personal data can be collected. Data subjects have a right to see personal data held about them.

Disclosure of Information
Trustees must provide certain information as a matter of course, and other information on request.

Information that must be provided about membership and benefits
All trustees have duties to produce certain information and documents on request to beneficiaries and other third parties. To a large extent, for pension trustees, these duties have been encompassed within a large and complex set of regulations, Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 ("**Disclosure Regulations**").

The Disclosure Regulations require trustees to provide scheme members (and certain other parties, such as contingent beneficiaries and trades unions with negotiating rights) with:
- basic information about the scheme as a matter of course, and
- further information about members' rights and benefits upon request.

Basic scheme information broadly includes details such as:
- eligibility for membership;
- contributions; and
- benefits.

This information would generally be found in the scheme booklet or member guide.

Other information that must be provided

- Summary Funding documents: Trustees must prepare a Summary Funding Statement to send to each DB member within three months of the completion of an actuarial valuation under the statutory funding regime.
- Annual benefit statements for money purchase schemes: Trustees must provide annual benefit statements to (broadly) all members with money purchase benefits, within 12 months of the end of each scheme year. The statement must, among other things, include:
  - the amount of contributions credited to the member during the scheme year;
  - the value of the member's accrued rights; and
  - where to find the information.

Part of the annual statement is the statutory money purchase illustration which provides personalised information to members about their pension fund, including an illustration of the likely projected pension at retirement.

For DB schemes, an annual benefit statement is often provided to members still accruing pension benefits as a matter of good practice.

Retirement wake-up pack: Where a member has a right or entitlement to flexible benefits, trustees and managers have to provide them with the following information:

- a statement of the options available under the scheme rules;
- where the member has an opportunity to transfer flexible benefits, information about the options available to them and their value, where they may access impartial advice and guidance about taking flexible benefits, the extent to which the values quoted are estimates and details of any guarantees or restrictions that could affect the values;
- where the member has a right or entitlement to benefits under the scheme that are not flexible benefits, that the member has that right or entitlement and how the member may access information about those benefits;
- a statement that there may be tax implications associated with accessing flexible benefits, that income from a pension is taxable and that the rate at which income is taxable will depend on the amount of income the person receives from a pension and from other sources; and
- where the member has accrued rights to non-money purchase flexible benefits, has not reached normal pension age and does not satisfy the ill health condition, information about reductions that will apply relative to NRA.

Information to be provided on request

Certain information must be provided either by providing a hard copy of the document or providing details of where a hard copy of the information is publicly available (if requested in hard copy form) or by making it available for inspection. This includes:

- information relating to the constitution of the scheme;
- copies of the scheme's annual report, and previous annual reports (up to 5 scheme years) if not previously provided;
- the latest SFP and actuarial valuation.

This information must be provided as follows:

- if the information is requested in hard copy form, it must be provided in that form. The scheme may charge the individual, an amount not exceeding the cost of producing and giving the information. Alternatively, if the information in hard copy form is otherwise publicly available, the trustees may instead give details of where it is available;
- if the information is requested other than in hard copy form, it may be made available free of charge for inspection at a place that is reasonable having regard to who made the request, or on a website.

Trustees' responsibilities for scheme governance
Having arranged to delegate many of their duties, and to take advice, trustees also need to ensure that they continue to monitor, on a regular basis, actions taken on their behalf. Broadly, they need to receive enough information to ensure that nothing is done in their name that they would be unhappy with, given their responsibilities.

This monitoring can take place in a number of ways, including receiving regular reports (for example, at trustee meetings) on such items as:

- membership numbers and movements;
- current funding levels in a DB and CARE scheme;
- benefits paid in a period;
- cash flows, actual and expected;
- actions taken from their last meeting;
- success and problems of arrangements made for scheme administration; and
- progress of the investment of the assets and their performance, usually quarterly.

Trustees would also expect to see drafts of such documents as:

- members' new booklets and announcements;
- annual report and accounts;
- benefit statements; and
- actuarial reports.

They may set out their objectives in the form of a business plan, reviewing it regularly to measure their progress.

Detailed guidance for trustees, to help them understand their legal obligations and follow good practice, is provided by TPR in the form of Codes of Practice and (where provided) Code-related Guidance and Regulatory Guidance. These provide practical guidelines on the requirements of pensions legislation and set out standards of conduct and practice that must be met.

Code-related Guidance provides further explanation on areas covered by a Code of Practice.

Regulatory Guidance is good practice guidance that provides information, education and assistance. It is intended to help trustees understand what pensions legislation requires and what is good practice in the governance and administration of pension schemes.

If a Code of Practice, Code-related Guidance and/or Regulatory Guidance have been published in relation to a particular subject, they must be read in conjunction with each other.

It is not a legal requirement to comply with every aspect of a Code of Practice and there is no penalty for not doing so, but any alternative approach must still meet the requirements of the legislation underpinning the Code of Practice. If those requirements are not met, then trustees may be faced with penalties.

When determining whether legal requirements have been met, a court or tribunal must take any relevant provisions of a Code of Practice into account. TPR can also direct schemes to take, or refrain from taking, actions based on what a Code of Practice says.

TPR must go through a consultation process before introducing a new Code of Practice or changing an existing one. The new or revised Code of Practice must then be approved by Parliament.

Governance standards
TPR is responsible for improving the way that workplace pensions are run and in relation to DC schemes there is legislation that requires DC trustees to meet minimum quality standards relating to:

- service providers e.g. their terms and conditions of service, standards of service, communication with those service providers and their ability to change those service providers;
- Chair of trustees, which TPR considers to be an important role. TPR expects trustee boards to have a "robust and documented" appointment process, which takes into account the leadership qualities of candidates and their ability to drive good practice within the scheme. The identity of the Chair must be provided to TPR. Among the Chair's specific responsibilities is signing off an annual Chair's Statement on how these minimum governance standards have been met in relation to the scheme members, which will be included in the scheme annual report and on an appropriate website. Failure to do so can result in an automatic fine by TPR. TPR has produced guidance and checklists for the Chair's Statement and PLSA (see "Pensions Industry") has produced a template for the Chair's annual statement;
- core scheme financial transactions. For example, investment of contributions, transfers of assets, member payments must be processed promptly and accurately;
- charges and costs borne by members. At intervals of no more than one year, trustees must:
  - calculate the charges (and transaction costs, if possible) borne by members;
  - assess the extent to which those charges and transaction costs represent good value for members;
  - review their default strategy and the performance of funds at least every three years. The review must include the extent to which any investment returns are consistent with the trustees' aims and objectives. Default funds are also required to have a SIP.

The FCA has also produced minimum quality standards for contract-based schemes (i.e. group personal pensions and stakeholder schemes). All providers of such contract-based schemes must establish and maintain an Independent Governance Committee ("IGC") which:

- assesses the ongoing value for money of workplace personal pension schemes;
- acts solely in the interests of relevant scheme members;
- raises any concerns with the provider's board;
- escalates their concerns to the FCA, if necessary; and
- reports annually on what they have done

IGCs have a duty to focus in particular on the default funds of the schemes operated by their provider. This is because most members use default funds more than any other type.

Charge controls
These requirements apply to DC schemes used as qualifying schemes for automatic enrolment purposes.

Schemes must ensure that funds in a default arrangement are not subject to charges in excess of a cap equivalent to 0.75% each year of funds under management, or an equivalent combination charge. The cap does not apply to transaction costs incurred as a result of buying, selling, lending or borrowing investments.

It is no longer possible to charge members for whom contributions are not being paid more than those for whom contributions are being received.

Administrative records

What records must be kept

Records need to be kept, of:

- trustee meetings and decisions;
- scheme documents including trust deed and rules, and any deeds of amendment or rule changes;
- changes in trustees, participating employers and sponsoring employer;
- member and beneficiary information;
- details of all contributions received;
- all other payments to and from the scheme, including benefit payments and payments to advisers or the employer; and
- details of transfers of members' benefits and related assets to and from the scheme.

TPR has issued guidance on data requirements, which breaks data recording requirements into three basic areas:

- common data – applicable to all schemes and includes members' personal data and some information about benefits;
- conditional data – dependent on scheme type, structure and system design; and
- numerical data – to aid understanding of the results.

Each scheme's data scores must be reported to TPR in the scheme's return. The data score is the percentage of members in the scheme for which there is full and accurate data. Common data and scheme-specific (i.e. conditional) data are scored separately.

The guidance is aimed at trustees, providers and administrators, who as well as checking that data exists, need to ensure that their data is accurate. It sets out a proposed framework for data checking.

Financial records and accounting

The trustees/providers need to have comprehensive records of receipts and payments so that they can produce the annual report and accounts. In practice, most of these records will be kept by administrators, investment managers and custodians. TPR requires trustees to have a good system of internal controls to ensure that adequate checks and balances are performed on a regular basis.

Audited annual reports and accounts have to be made available to the members of most schemes within seven months of the end of the scheme year to which they relate. The contents of the annual report and accounts are specified in the Disclosure Regulations.

TRUSTEESHIP

A trustee is a person (which can include a company) who legally owns assets, but who must apply those assets and any income/gains arising from them, only for the benefit of another person or group of people. The main reason for using a trust, and thus trustees, for a pension scheme is to separate the pension assets from those of the employer. It also ensures that third party beneficiaries (such as spouses/civil partners and dependants) have legal rights. Trustees, generally, are bound by a body of law, known as "trust law", as laid down by the courts over time, and added to by several Acts of Parliament. However, trustees of workplace schemes are also required to comply with various statutory provisions, the majority of which are set out in the Pension Schemes Act 1993, the Pensions Act 1995 and the Pensions Act 2004.

Contract-based schemes do not have trustees and therefore are not subject to any of the law that applies to "trust schemes". They are governed mainly by financial services law, overseen by the FCA and the PRA.

The main duties of occupational pension trustees are set out below.

Types of trustee

As well as individuals who act as trustees, there are:

Corporate trustees
A company which acts as trustee is often a specially named and constituted subsidiary company of the sponsoring employer. The corporate trustee has trustee directors, but the trustee directors have the same role as individual trustees. As with member-nominated trustees, there is also a requirement to have member-nominated directors.

One administrative advantage offered by using a corporate trustee is that there is no need for a new trustee to be appointed when a director dies or retires, as is the case with individual trustees, although Companies House has to be notified of new and retiring directors and company secretaries. However, the procedure is simpler. Also, the investments of the pension fund are not held in the names of individual trustees or directors but are registered in the name of the corporate trustee. There is no need to transfer investments out of the name of a retiring individual trustee and into the name of a new individual trustee since the investment is held in the name of the trustee company.

Independent trustees
Individuals often act as independent trustees. Usually they are, or have been, lawyers or actuaries, or other pension specialists. In addition, there are organisations which offer independent trustee services, including banks, consulting actuaries, pension consultants and pension lawyers, usually through a subsidiary or associated company. There are also specialist trustee companies that offer this service.

Independent trustees are paid; therefore, a greater degree of vigilance and professionalism is expected from them than from ordinary trustees. They are able to bring in-depth knowledge and understanding to the role of trustee. Their independent status should help clarify the issues when conflicts of interest arise with the sponsoring employer. The use of an independent trustee shows a further separation of control of the scheme's assets from the employer, and this can be reassuring to the members.

Independent trustees do not have to be qualified or registered. The exceptions to this include:

- TPR's register of independent trustees. TPR can, under certain conditions set out in the Pensions Act 1995, remove trustees from office, or appoint additional trustees to act with the trustees. Independent trustees can take their fees directly from the scheme and/or the employer. An independent trustee does not have to be on the TPR register in order to be appointed by TPR, but, in practice, it is unlikely an unregistered trustee will be appointed. Anybody wishing to be added to TPR's register must go through an application process that incorporates fact-based and judgement-based criteria;
- all trustees are required to have knowledge and understanding of their role ("TKU"). There is no set way for trustees to acquire TKU. Many independent organisations, including the PMI, offer trustee courses, as do many scheme advisers. TPR has compiled an online "Trustee Toolkit" which is free and designed to be studied in modules.

Member-Nominated Trustees/Directors (MNT/MND)

Under the Pensions Act 2004, at least one third of trustees, or directors of a company that acts as a trustee, have to be member-nominated. If a scheme has fewer than 100 members, there must be at least one MNT/MND; if 100 or more, there must be at least two. The requirement for MNTs/MNDs does not apply where all the trustees or directors of a corporate trustee are independent of the scheme and its employers, so does not apply where a sole independent trustee is appointed.

Pensioneer trustees

Pensioneer trustees were a specialised type of trustee that HMRC required to be appointed to a SSAS up to 5 April 2006. Unlike other types of trustees, pensioneer trustees had to be approved by HMRC. They had to demonstrate experience of, and a history of, working with SSASs. The role of pensioneer trustee was abolished on and from 6 April 2006. SSASs no longer need to appoint one and many removed their pensioneer trustees immediately. Most SSAS providers insist that the SSASs under their control have a professional trustee (usually an associated company), in order to ensure that HMRC requirements are not breached, either deliberately or inadvertently, resulting in substantial tax penalties.

Requirements for being appointed as a trustee

Generally, anyone who is aged 18 and over and of sound mind can be a trustee but there are some people prohibited by law from becoming pension trustees, including

- the Scheme Actuary;
- the Scheme Auditor;
- anybody who:
  - is convicted of an offence involving dishonesty or deception (unless the conviction is spent);
  - is an undischarged bankrupt, or has entered into certain other voluntary agreements with creditors;
  - has been disqualified from acting as a company director;
  - has property in Scotland which is covered by a sequestration order;
  - is a company and any director of the company has been disqualified from being a trustee; or
  - is a Scottish partnership where any of the partners has been disqualified from being a trustee.

Any trustee who has been validly appointed, but who subsequently falls into a prohibited category, must cease to be a trustee at that point.

There is normally no maximum limit on the number of trustees that can be appointed, although every trust must have at least one trustee. A pension scheme must have a minimum of two, if they are individuals.

Trustees of master trusts that provide DC benefits are, additionally, subject to a new regulatory regime contained in the Pension Schemes Act 2017. In particular, a DC master trust must have at least three trustees, or three directors in the case of a corporate trustee. The majority of the trustees or directors must be independent of any entity which provides advisory, administration, investment or other services to the master trust. The PSA 2017 also introduces a “fit and proper person” regime for master trust trustees.

Trusteeship Trust documents

Trust-based schemes are generally governed by trust documents. It is also possible for non-trust documents to be counted as governing documents, but this is uncommon. Such documents may include:

- scheme explanatory booklets, and
- employer announcements.

There have been occasions when, although there has been no intention to count them as scheme governing documents, the courts have found that an explanatory booklet and/or employer announcement has been so significant that it must be treated as a governing document binding the employers, trustees and/or members.

Setting up the pension scheme

There are a number of ways of setting up a trust-based pension scheme. If it is wished to set the scheme up quickly, any of the following methods can be used. Otherwise, the employer and trustees can proceed direct to the Definitive Trust Deed stage, where the entirety of the scheme’s trust provisions and rules are set out in one document. Now that HMRC has strict procedures for approving and registering schemes, the “quick” procedures are rarely used.

The “quick” procedures usually involve a short document, setting out the scheme basics such as a declaration that the pension scheme will conform to HMRC’s requirements, setting out the power to appoint and remove trustees, invest the scheme’s assets (of which they are the legal owners) and amend the scheme provisions. Sometimes, a short, high level, summary of the benefits to be provided are included.

Interim Trust Deed

In the past a temporary trust deed was used to set up the administrative arrangements and to obtain the interim approval from the then Inland Revenue (now HMRC) so that tax relief could be claimed on employer contributions. This was called the “Interim Deed”.

It allowed immediate tax relief on a provisional basis and covered all the relevant rules. It gave powers and obligations to the trustees to allow them to operate the pension scheme. It was only temporary (due to be replaced by the Definitive Trust Deed) and normally expired after 2 years, although this period could sometimes be extended. In practice, interim trust deeds are little used now.

Declaration of Trust

This type of document is commonly found when the assets of the pension scheme are totally invested and administered by an insurance company. In effect, it covers the same provisions as an interim trust deed. Its function was identical to an interim trust deed.

Exchange of Letters

This way of setting up a pension scheme trust was commonly used for establishing individual arrangements for senior employees. It was common before directors were allowed to participate in occupational pension schemes (in the 1970s) and when unapproved benefits were set up, following the implementation of the pensionable salary cap in 1989, which ceased to apply in 2006. They are not common, otherwise. However, sometimes the benefits from the employer’s scheme for senior employees are varied by individual letters.

Where the arrangement is a fully insured scheme, the exchange of letters usually takes the form of a standard letter, with attaching rules provided by the insurer.

Board Resolution

The directors of the employer setting up the pension scheme under trust can do so by passing a special board resolution. The resolution must be minuted in writing and the content of the deed and rules must also be recorded.

A pension scheme can only be set up in this manner if the employer has the power (for example, under its Memorandum and Articles) to set up a trust.

(Definitive) Trust Deed

The Definitive Deed usually has two main parts - the Trust Deed, and the Rules.

The Trust Deed normally defines the powers and duties of the trustees and the employer, and the duties of trustees to the members.

The Rules normally cover scheme administration and benefits. Rules are either incorporated into the Definitive Deed as a schedule or remain as a separate document. The Rules are normally brought into force at the same time as the Definitive Deed. The actual content of the Trust Deed and Rules will be broadly similar for all schemes and would normally include the following:

- the date of execution and effective date of the deed (which may be different);
- parties to the trust (usually principal employer and trustees);
- recital covering previous deeds;
- incorporation of schedules and rules;
- power to appoint and remove trustees and protections for the trustees;
- power to amend the scheme;
- power to admit associated companies;
- special and general powers of augmentation;
- power of investment;
- power to deduct tax and insure assets;
- details of general administrative arrangements;
- triggers for winding up and procedures to be followed:
- administrative matters, such as payment of benefits, requirement for scheme accounts and actuarial valuations of DB schemes and (where required) other compliance with pensions legislation.

The Rules cover:

- scheme eligibility conditions;
- member and employer contributions;
- benefits on leaving, ill health, retirement or death;
- payment of benefits;
- transfers in and out of the scheme;
- contracting out provisions (where GMPs and other contracted-out rights/benefits continue to exist after 6 April 2016 in a DB scheme, or where a DC scheme chooses to continue to apply protected rights restrictions after 6 April 2012).

Other deeds relating to the pension scheme

- Deeds appointing and removing trustees;
- Deeds admitting other employers into participation of a scheme, so that their employees can benefit from the scheme;
- Deeds amending, and sometimes replacing in their entirety, trust provisions and rules.

Appointment and removal of trustees

In a workplace occupational scheme, the power to appoint and remove trustees is set out in the Trust Deed. Typically, the power is given to the Principal Employer.

There is limited power to appoint and remove trustees in the Trustee Act 1925.

The court also has power to appoint trustees under the Trustee Act 1925, under certain circumstances.

TPR has power to appoint and remove trustees – instead of, or as well as the incumbent trustees - under certain circumstances (see “Role of Government”). It can also prohibit people or organisations from being trustees of one or more pension schemes.

Trustees can retire as trustees, usually on giving the Principal Employer a minimum period of notice.

MNTs usually cease to be so on the happening of certain events, e.g. transferring their benefits out of the scheme. This is not automatic, and a term should be written into the scheme rules to enable it to happen.

Appointment and removal of trustees is normally carried out by deed. A deed of appointment has the advantage that it automatically transfers the scheme assets into the names, jointly, of the existing and new trustees. Sometimes, additional actions have to be undertaken, such as transferring real property into the names of the new trustees on, and removing former trustees from, the register of title at the Land Registry.

Trusteeship Responsibilities

There are general trust principles that apply to all trustees, whether or not they are pension trustees.

General duties and responsibilities under trust law.

Must act prudently

Based on a legal case, decided in 1883, trustees must “take such care as an ordinary prudent man of business would take in managing his own affairs”. This does not mean if they were only considering their own position, but what they would do if they were under a moral duty to provide for others.

A higher standard of prudence is applied to trustees holding themselves out as having special skills, or acting in a paid, professional capacity.

Must always act within the terms of the governing documentation and for the benefit of the beneficiaries
Trustees must only operate within the terms of the scheme's governing documentation. Otherwise, their decisions and actions may be unlawful and could be overturned by TPO or higher courts (if someone successfully complains), often with disastrous consequences for the members and/or employers.

If trustees commit an act not sanctioned by the trust documentation, or if they omit to carry out their duties as required, they can be sued for breach of trust by the affected beneficiaries. If they do not comply with legislative requirements, trustees can also be subject to financial penalties under legislation and/or replaced as trustees by TPR. Replacement of trustees is normally only carried out where there have been persistent and deliberate breaches of pension law, or a one-off breach is so serious that no competent trustee would ever have committed it.

Trustees are expected to act in good faith and with reasonable care, taking advice where matters are not easily understood, and within the framework of the law.
Sometimes trustees' duties are set out in overriding legislation that is not always contained in the governing documentation. Because of the costs and time involved in making changes to rules, there may be a time-lag before the new requirements are built into the governing documentation, but the trustees must always observe over-riding legislation.

Governing documents do not always set out exactly what trustees and employers should do in all situations. In certain areas of the administration of a pension scheme, the trustees and employers have an element of discretion as to how to exercise their powers. Examples are:
- who should receive lump sum death benefits when a member dies?
- should pensioners receive discretionary pension increases?

Death benefits are payable in accordance with the governing documentation, which will normally provide that the trustees have certain discretions about how to deal with them. Where a benefit is discretionary and the employer and/or trustees exercise their powers in good faith, following certain well-defined principles laid down by the courts, their decisions are unlikely to be overturned by the court.

Must act in the best interests of all the beneficiaries
Trustees must act independently, and represent all members and beneficiaries, no matter whether they were appointed by members, employers or any other party. Usually this means acting impartially though, exceptionally, for example in distributing a scheme surplus, the trustees could act in a way which benefits one group of beneficiaries, rather than another, provided all relevant factors have been taken into account. Trustees should not make investments, or refuse to do so, based on their own views of the rights and wrongs of investing in certain types of assets, but always in the interests of the stakeholders. The latter may include the sponsoring employer of a DB scheme, unless its interests conflicted with those of the beneficiaries, and the PPF.

Should not seek to benefit under the terms of the trust
Trustees must not use the trust assets for their own advantage, even if by doing so, the scheme benefits. The trust documentation would need to allow a trustee to benefit in this way. An exception to this is that a trustee can be a member of the pension scheme and a professional trustee can charge for its services, if the scheme rules allow.

May delegate their powers or duties if the scheme documentation allows them to do so
If the trustees choose to delegate powers or duties, the overall responsibility for any actions taken remain with them. They are not responsible for advice given to them, as long as they have taken steps to ensure that the adviser has the necessary experience and is acting competently.

Have a duty to invest the trust assets
The Pensions Act 1995 says that trustees have the same investment powers as if dealing with their own money, but subject to any restriction in the trust documents. It goes on to say that the trustees must maintain a written SIP – a statement of the principles to be used in making decisions about investments. The statement must set out the trustees' policy on, for example:
- diversification of investments;
- attitude to risk;
- the expected return on investments;
- socially responsible investment.

The trustees bear ultimate responsibility for investment performance, but in practice their decision-making powers may be delegated to one or more external fund managers. The trustees are not liable for the fund manager's actions as long as they have taken steps to ensure that they have the necessary experience and are acting competently. Trustees generally monitor investment performance at their regular meetings and for larger trustee bodies there is often an investment sub-committee which reports back to the main body. This ensures that trustees are aware of the rate of return achieved by a fund's assets.

Must keep proper records of transactions and prepare accounts to give a clear and accurate view of the trust property
Accounts must be audited and made available to the members on request along with the trustees' annual report, where there is more than one member in the scheme. The Disclosure Regulations set out the minimum information that must be included in audited pension fund accounts.

Avoid or manage conflicts of interest
Pension trustees must be alert to the possibility that they, or their co-trustees, could be affected by a conflict of interest. The potential for conflicts of interest is enhanced in pension schemes, because trustees are often nominated by the members or by the employer and may consider that they owe a higher duty to those who nominated them. This is not correct. Once appointed, a trustee is responsible for all beneficiaries and all aspects of operation of the scheme. Trustees who have a position on the board of directors of the sponsoring employer must be careful that their position does not cloud their judgement e.g. when negotiating contribution rates with the employer. Trustees who are members must be careful not to let their personal position cloud their judgement when e.g. considering employer requests to reduce future benefits or increase member contributions. Pension scheme trustees must keep, and maintain, a policy on managing conflicts of interests.

Trustee knowledge and understanding.
As well as knowing the terms of their trust and being conversant with the governing documents, trustees are under a statutory duty to have "knowledge and understanding" of:
- the law relating to pensions and trusts;
- the principles relating to the funding of occupational pension schemes and investment of the assets of such schemes; and
- such other matters as are prescribed. To date, there has not been any subordinate legislation prescribing additional matters.

The actual level and standard of what is known as "TKU" can vary from scheme to scheme. Large schemes, with complex benefit and membership structures and massive funds under management will need trustees with higher levels of TKU than the trustees of a small DC trust-based scheme, although TPR is increasingly imposing more onerous requirements on trustees of DC schemes.

Guidance on TKU is available from TPR.

Additional duties of pension fund trustees.
There are many additional duties that pension trustees must observe, over and above trust law, which are more administrative in nature and imposed under statute and regulation. These are outlined in "Workplace Pension Schemes", under "Administration and Governance".

Trustee Liability and Protection
It is quite clear that being a pension trustee is an onerous obligation and there is a risk of penalties, sanctions and legal action against trustees. In practice, most disputes are resolved without recourse to any of these measures; through the Internal Dispute Resolution Procedure (which the trustees are required by statute to establish), or via TPO.

Trustees can be protected against liability by means of provisions in the governing documentation, usually found in the "exoneration and/or indemnity clauses".

Exoneration clauses set out that trustees are not liable for their own defaults, except for (usually):
- their personal dishonesty;
- their own actual fraud;
- certain breaches in relation to investment duties, where it is the trustees who have committed the breaches, rather than a properly appointed investment manager;
- reimbursement of fines and penalties imposed by TPR.

The individual clauses can and do vary in their wording and effect. It is common for professional trustees to receive a lower level of protection and to be held liable for their own negligence. This is because they are holding themselves out as having special skills and ought to have professional indemnity cover of their own.

In addition, many documents contain clauses requiring the sponsoring employer to indemnify the non-professional trustees for the results of their own honest mistakes, under the terms of the exoneration clause. If the employer(s) cannot or will not indemnify the trustees, trustees can use trust funds for this purpose.

Subject to the scheme's rules, this may only be possible where there is a pool of money available for this purpose. Otherwise, it would mean that trustees would have to be indemnified from individual member pots in a DC scheme.

Most trustee boards now take out trustee indemnity insurance, or the employer arranges cover on their behalf. The insurance, if purchased using scheme assets, cannot cover fines and penalties imposed by TPR (although employers can provide this cover from their own resources), nor will any insurance cover dishonest acts.

Trustee liability insurance falls into two broad categories:
- protection for trustees in ongoing schemes; and
- insurance cover on winding-up.

There is also limited protection available under section 61 of the Trustee Act 1925, Under this section, the court has discretion to relieve a trustee from personal liability if it appears that a trustee "has acted honestly and reasonably and ought fairly to be excused". It is not wise for trustees to seek to rely exclusively on this provision, since it (a) is discretionary and (b) has proved to be a difficult test to pass.

INDIVIDUAL PENSION PROVISION

Pensions that can be taken out by individuals.

Personal pensions
Personal pensions were introduced on 1 July 1988, replacing retirement annuity contracts ("**RACs**"), to allow people greater opportunity to save for retirement on a private basis. They are DC pensions, providing benefits on a money purchase basis. Apart from those who already had an existing RAC and until the introduction of stakeholder pension schemes in April 2001, personal pensions were the only pension arrangements available for the following:
- those who were self-employed;
- those in non-pensionable employment;
- anyone who had opted out or chosen not to join a workplace scheme offered by their employer; and
- those in an occupational pension scheme that was not contracted out. A personal pension could be taken out for contracting out purposes only.

A personal pension plan can accept transfers from other pension arrangements. Before 6 April 2006, tax relief on contributions to a personal pension was limited to a percentage of qualifying earnings until stakeholder pensions were introduced and contributions could be paid up to £3,600 each year without reference to earnings.

Before 6 April 2006, subject to any protected rights restrictions (see "Workplace Pension Schemes") retirement benefits could be taken any time between age 50 and 75, with up to 25% of the fund available as a tax-free lump sum and the balance used to purchase an annuity (with no limit on the amount of pension payable). If the fund value was below a certain level it was possible for the member to take their benefits as a lump sum on grounds of triviality. However, a lump sum on grounds of serious ill health was not available (as it was in an occupational pension scheme).

If a personal pension was used for contracting out before 6 April 2006, it had to comply with the protected rights requirements that applied at that time. Protected rights could not be taken before age 60 and could not be commuted for tax-free cash except on grounds of triviality. Also, annuities purchased with protected rights had to have compulsory increases in payment.

From 6 April 2006, personal pensions became subject to the same requirements as any other registered pension scheme in terms of contribution limits and the types of benefit they could provide, and scheme rules (and contract terms) had to be adapted to comply with the requirements of the new pensions tax regime - further information about the new pensions tax regime is given in "Role of Government".

However, personal pensions will continue to be different in other respects from occupational pension schemes and other types of pension arrangement.

Employees can be members of both an occupational pension scheme and have a personal pension at the same time (concurrent membership). The policyholder must normally be offered various types of annuity from which to choose (e.g. single life, joint life, without and with a time guarantee, and non-increasing or increasing at various levels). Importantly, there is an open market option ("**OMO**") as part of the terms of the policy. This means that an individual can shop around the annuity providers to get the best annuity in exchange for the proceeds of their policy (after having taken the tax-free lump sum, of up to 25% of the fund). There are FCA rules in place which require certain information to be provided about the OMO and the pension flexibilities that were introduced from 6 April 2015..

Up until 6 April 2012, personal pensions could accept the NI rebates if they were used for contracting out and were called Appropriate Personal Pensions (“APPs”). Members of occupational pension schemes who were not contracted out could take out an APP which only accepted NI rebates – a rebate-only personal pension. Contracting out on a DC basis was abolished on 6 April 2012.

Personal pension schemes can be used as qualifying pension schemes for automatic enrolment purposes.

Stakeholder pensions
Stakeholder pensions were introduced from 6 April 2001 and employer arrangements had to be in place, where required, from 8 October 2001. A stakeholder pension is a type of personal pension. However, there are stricter compliance requirements for stakeholder pensions and a limit on charges which is lower than the cost of most other arrangements.

TPR and the FCA monitor compliance requirements.

Up until 1 October 2012, access to a stakeholder pension arrangement had to be offered by any employer with five or more staff, unless it offered an occupational scheme that satisfied certain minimum eligibility criteria, or a group personal pension which met certain standards. The requirement to provide access to a stakeholder pension arrangement was abolished when automatic enrolment was introduced, although employers must continue to deduct and pay across contributions for existing members of a stakeholder scheme.

Before 6 April 2006, tax relief on contributions to a personal pension was limited to a percentage of qualifying earnings. However, when stakeholder pensions were introduced, contributions could be paid up to £3,600 each year without reference to earnings.

Employers are not obliged to contribute to stakeholder pension arrangements.

Employees can be members of both an occupational pension scheme and have a stakeholder pension at the same time (concurrent membership).

Management charges under a stakeholder scheme are restricted to 1.5% during its first ten years of existence and 1% p.a. thereafter.

Although the trustees or scheme managers determine the range of investment options, they must set a suitable “default” investment option for members who were unable or unwilling to make an investment decision.

This ‘default’ fund must offer a “life-styled” investment switch so that members’ investments are moved into less volatile asset classes as they approach their chosen retirement age, but only for new members from 6 April 2005.

Stakeholder pension schemes can be used as qualifying pension schemes for automatic enrolment purposes.

Retirement Annuity Contracts (RACs)
RACs are a type of pension plan that someone could take out, up to 1 July 1988, when they were replaced by personal pensions.

RACs were available to those in employment where there was no access to an occupational pension scheme and to those in self-employment, provided they had earnings subject to UK taxation.

Since 1 July 1988, no new RACs have been able to be taken out, but those already holding these contracts are able to continue to contribute to them. Before 6 April 2006, RACs differed from personal pensions. For example:
- benefits could not normally be taken until age 60 except on grounds of incapacity;
- there was no OMO available to allow the policyholder to buy an annuity elsewhere - although a transfer could be made to another, pre-existing RAC to take advantage of the annuity rates available under that other RAC (or to a personal pension);
- the maximum lump sum at retirement was three times the initial annual amount of annuity remaining after the commutation;
- there was no full commutation allowed on grounds of serious ill health or triviality.

From 6 April 2006, under new rules introduced by HMRC, RACs were put on the same basis as personal pensions and almost all of their special features no longer apply.

From 6 April 2006, RACs became subject to the same requirements as any other registered pension scheme in terms of contribution limits and the types of benefit they could provide, and contract terms had to be adapted to comply with the requirements of the new pensions tax regime.

Additional Voluntary Contributions (AVCs)
AVCs can be paid into an occupational pension scheme. They are contributions paid voluntarily by members, in addition to any contributions they are required to make. Many DB schemes used to provide additional pension service in return for AVC but most commonly they were invested either in an insurance company or other deposit account eg with a bank or building society. The employer usually takes the contributions directly from the employee's pay.

They can go into the employer's main scheme (or a separate scheme) or into a separate arrangement run by an external provider, such as an insurance company, attached to the main scheme. Where there is a separate AVC arrangement, the benefits payable are subject to the rules of the main scheme.

Some schemes, such as the public sector schemes and private DB schemes, offer a choice of investment-based facilities (i.e. the AVCs provide DC benefits) or the opportunity to buy 'added years' of service. Added years are only applicable to DB schemes, and the cost of purchasing this type of extra pension is determined on an actuarial basis.

Investment based AVCs are often run by an external source such as an insurance company, on terms that are favourable to members, such as reduced charges and enhanced investment rates.

Until 6 April 2006, payment of, and benefits paid from, AVCs were subject to limits set by HMRC. AVC benefits had to be taken at the same time as the member's main scheme benefits (unless the scheme rules specifically allowed otherwise) and in pension form, the exception being members who began paying AVCs before 8 April 1987, who could take part or all of the AVC benefits as tax-free cash.

From 6 April 2006, AVC benefits are payable from a registered pension scheme, or from a separate arrangement contained within such a scheme (e.g. the member's main scheme benefits in a DB scheme are held in a DB arrangement and the AVC benefits in a DC arrangement). The new pensions tax regime therefore applies in terms of contribution limits and the types of benefit allowable. If the AVC benefits are held in a separate arrangement within the scheme, the scheme rules can allow all of the AVC benefits to be taken as tax-free cash so that the member does not need to give up part of their main scheme pension.

Free Standing Additional Voluntary Contributions (FSAVC)
FSAVC schemes are separate from the employer's main occupational pension scheme and are provided by insurance companies, friendly societies, building societies, banks and unit and investment trust companies.

As the additional contributions are not paid into the main scheme, this can allow a choice of provider, more flexibility, confidentiality and control, although member charges may be higher than for AVCs.

Before 6 April 2006, FSAVC arrangements had an advantage over AVCs because when a member left one employer to join another, they could take their FSAVC arrangement with them (which was not possible with AVCs) and the FSAVC benefits did not have to be taken at the same time as the member's main scheme benefits once the member left the employment the main scheme related to (which, again, may not have been possible with AVCs). However, FSAVC benefits were still subject to HMRC limits for occupational pension schemes. This limited how much a member could pay into a FSAVC arrangement and the FSAVC benefits which could be paid on retirement and death. FSAVC benefits had to be taken at the same time as the member's main scheme benefits if the member was still in employment, and in pension form (as no tax-free cash was allowed).

FSAVC arrangements were also not available to all members. A special 'headroom test' had to be carried out if proposed FSAVC contributions exceeded £2,400 in the tax year (to ensure that overall HMRC maximum benefit limits were not going to be exceeded when other occupational pension scheme and AVC benefits were taken into account).

From 6 April 2006, FSAVC schemes became subject to the same requirements as any other registered pension scheme in terms of contribution limits and the types of benefit they could provide, and the scheme rules and contract terms had to be adapted to comply with the requirements of the new pensions tax regime.

As occupational pension scheme members can now choose personal pensions and stakeholder pensions as a vehicle for paying extra pension contributions, this has meant that while FSAVC schemes can continue to operate, they have lost the attraction that they once had and are becoming obsolete.

Buy-out contracts
A buy-out contract is an individual insurance contract purchased by the trustees of an occupational pension scheme to provide benefits at retirement or death in respect of a former scheme member. This type of contract is commonly referred to as a "section 32 policy" (although, strictly speaking, not all buy-outs are section 32 policies) or as a "deferred annuity contract".

In some cases, when an individual member takes a transfer from an occupational pension scheme on leaving the scheme, they can choose to have their transfer value paid to a buy-out provider of their choice. When this happens, the member is making an investment choice and the buy-out contract will normally provide a fund on retirement which can be used to provide benefits on retirement which are different from the benefits which were available under their employer's scheme.

In other cases, a buy-out contract can be used to secure members' benefits on winding up of a DB occupational pension scheme, or where such a scheme wishes to secure the benefits for preserved members so that it does not need to allow for the liability for those benefits for scheme funding purposes. Other types of occupational pension scheme may also need to buy out members' benefits. The buy-out provider is chosen by the scheme trustees and the buy-out may take place without the member's consent. This type of transaction is normally referred to as a "bulk buy-out" as benefits are secured for a group of members, although each member can still get an individual buy-out policy in their own name. Individual policies will be issued, unless the buy-out policy is on a group basis in the name of the scheme trustees, in which case the benefits are still provided by the occupational pension scheme even though they have already been secured.

Contracted-out rights can be transferred to, or secured by, a buy-out contract. If the transferring scheme was a contracted-out salary-related scheme, liability for providing the member's GMP or post-April 1997 contracted-out rights is transferred from the scheme to the buy-out provider.

Protected rights could also be secured under a special type of buy-out contract on winding up of a contracted-out money purchase scheme before the abolition of DC contracting out and protected rights on 6 April 2012.

Before 6 April 2006, a buy-out contract was an HMRC-approved contract (or had to be a standard contract that satisfied certain conditions) and it provided benefits on retirement and death along the same lines as an approved occupational pension scheme. Maximum benefit limits had to be written into the contract.

Buy-out contracts in existence immediately before 6 April 2006 automatically became registered pension schemes from that date. The benefits provided must now be in line with the current pensions tax regime and contract terms had to be adapted to comply with the new requirements.

Self-Invested Personal Pensions (SIPPs)
A SIPP is a type of personal pension which allows a more flexible approach to investments. The member can therefore, to a large extent, decide on the investments to be held under the arrangement but those decisions may be limited to a degree by the terms and conditions of the contract with the SIPP provider. Although the member has control over the investment strategy, it is the SIPP provider that makes the investment and deals with the usual scheme administration.

Investment restrictions apply to a SIPP in its capacity as an Investment Regulated Pension Scheme, in the same way as for SSASs.

Apart from these particular characteristics, however, a SIPP is a type of personal pension, subject to the same rules before and after 6 April 2006 regarding contribution limits, although an "in specie" contribution (where rather than making a cash contribution, assets such as property or shares are paid to the SIPP instead) is a fairly common occurrence.

Where payment of benefits is concerned, SIPPs are likely to offer wider options as to how benefits can be taken on retirement and death, including income withdrawal.

Personal Savings and Investments

Building society and other deposit accounts
People often have some money on deposit, even if it is only a modest amount. It is the most common method of saving. Cash is deposited with a building society or other deposit taker, sometimes on specific terms as to the interest rate to be applied and/or the period of time for the deposit.

If there are no special terms, then the cash is normally available instantly and the interest rate can be varied at the will of the provider. Since 6 April 2016 the income is paid gross by the provider (no tax is deducted). However, it may be subject to income tax depending on the individual circumstances of the investor. This is dealt with between the investor and HMRC, via self-assessment. The income from these accounts varies according to the general level of short-term interest rates in the economy. The capital is secure; the main risk is from reducing interest rates, and inflation eroding the value of the capital.

Share plans
Share ownership enables employees to participate in the financial success of their company. Employers may see this as a useful motivational tool to improve their employees' commitment and performance. Employees who have a stake in the company they work for are, it is hoped, going to have a greater interest in its financial performance and a better understanding of the need for profit.
Employers can encourage employee share ownership schemes in two ways:

- by allowing employees to buy shares at an advantageous price (option schemes); and
- by giving shares to employees

In some schemes, employees will have to wait for a period before the shares become theirs, and this can also aid staff retention.

Governments have encouraged employee share ownership by giving tax privileges to approved schemes. There are also other 'unapproved' arrangements. The most common of the approved arrangements are:

- Company Share Option Plans ("**CSOPs**");
- SAYE share option schemes;
- Share incentive plans.

Employers can currently grant employees options on up to £30,000 worth of shares each. The share price, fixed on the day the option is granted, must not be lower than the share's market value on that day. The employee can exercise their options after a specified period. If they do so, it is at the fixed price, not the market price at that time. With effect from 6 April 2023, the limit on the grant of options to an employee will be increased to £60,000. Employees do not pay income tax on the grant of the option.

If the employee sells their shares at a profit, no income tax or NICs are due on the gains, if certain conditions are met. Broadly, the option must be exercised through a scheme that is still approved and there must be a minimum period of three years between the grant of the option to an employee and the exercise of the option by that employee. However, Capital Gains Tax ("CGT") may be payable if gains exceed the employee's annual tax-free allowance.

The employer can get corporation tax relief for the costs of establishing and administering the CSOP and for the cost of providing shares under the scheme. Before granting options, the employer must obtain HMRC approval.

When the shares are sold, CGT applies. It is payable, broadly, on the difference between the acquisition or base price. Taxpayers have a CGT exemption in each tax year, so if the exemption has not been used each year, the gain over the base price has to be more than the exemption before any tax is payable. CGT liability can be further reduced by taper relief, if the shares have been held for a long time.

Save As You Earn (SAYE) share options
SAYE share option schemes allow employees to save up to a maximum of £500 per month to purchase shares at a discount of up to 20% of the share price at the beginning of the scheme, when the options are issued. The savings are deducted from salary after tax, month by month and the money saved with guaranteed rates of interest. At the end of the period chosen the savings can be used to exercise the options to purchase shares. The employee can choose to save over three or five years. There are no tax liabilities when they come to exercise their option to buy. CGT may be payable if the shares are sold, but the exemption mentioned above applies. The employee won't need to pay any CGT if they put the shares into an Individual Savings account ("**ISA**") or a pension as soon as they buy them.

This is a no-lose situation for employees, because, if the shares have not performed, the savings can be withdrawn with tax-free bonuses and the option not exercised. If an employee leaves service, the option may be lost, but the savings scheme can be continued to maturity.

Share incentive plans
Also known as 'all employee share plans'. They offer various alternatives that allow employees to acquire shares in their employing company in a tax efficient way.
There are four main parts:

- partnership shares;
- matching shares;
- free shares; and
- dividend shares.

Employees can purchase partnership shares by allocation of up to 10% of their salary up to a maximum of £150 per month. Matching shares can be up to two shares for each partnership share purchased and free shares can be awarded up to a maximum value of £3,600 per tax year. If the employee receives dividends from free, partnership or matching shares, they can use them to buy more shares under the plan. They won't have to pay income tax if they keep the dividend shares for at least five years. The extent to which these various alternatives are available is at the option of the employer. Participation in the plan must be open to all employees on similar terms.

If the shares are held in trust for five years there are no income tax or NI implications for the employee, and there is no CGT payable on the growth in the value of the shares if they are held for the five-year period. Less favourable tax rules apply for holding periods of less than five years.

Individual Savings Accounts (ISAs)
Each tax year, everyone over the age of 16 has an ISA "allowance", which sets the maximum that can be saved within the tax-free wrapper during the tax year. Stocks and shares or innovative finance ISAs, cash ISAs and lifetime ISAs are not available to anyone under the age of 18.

The maximum which can be saved in the 2021/22 tax year is £20,000 which can be split in any way across the different types of adult ISA, apart from a Lifetime ISA, where the maximum that can be invested in any one year is £4,000. Savers invest from net earnings (as, unlike for pensions, there is no tax exemption on contributions).

However, all income and capital gains within an ISA are tax exempt.

If the ISA is a "flexible" ISA, it allows withdrawals to be made without affecting the yearly allowance. A transfer can be made from one (type of) ISA to another at any time, but the whole of any savings in the current tax year must be transferred – a partial transfer is allowed of savings in previous tax years.

Although special rules apply for lifetime ISAs, there are no restrictions applying to access; a saver may withdraw funds from an ISA at any age without losing any tax benefits, but certain conditions or charges may apply under the terms of a particular contract.

There are two main types of ISA – the adult ISA and the Junior ISA.

Adult ISA

There are four savings options available:

- cash ISA;
- stocks and shares ISA;
- Innovative Finance ISA; and
- Lifetime ISA.

ISAs are provided by fund managers, banks and building societies. Savers may invest in cash, in which case the product works in much the same way as a bank or building society account, or in stocks and shares. It is common for a stocks and shares ISA to operate as a wrapper containing investments in unit trusts and Open-Ended Investment Companies ("OEIC"s). Funds may be withdrawn at any time (subject to the terms of the particular ISA), or held for life.

Innovative Finance ISA

The Innovative Finance ISA has been available since 6 April 2016. This new ISA allows individuals to use some (or all) of their annual ISA allowance to lend funds through the growing peer-to-peer lending market (loans given to other people or businesses without using a bank), whilst receiving tax-free interest and capital gains.

The interest rates offered by the Innovative finance ISA providers can be much higher than the rates offered by cash ISA providers, because peer lending cuts out the "middle man" bank, allowing borrowers to pay less in interest but also allowing investors to receive more. However, this type of investment involves an element of risk and, unlike a UK bank or building society account, peer-to-peer lending may not be protected by the Financial Services Compensation Scheme.

Lifetime ISA

The Lifetime ISA was introduced from 6 April 2017, for individuals between age 18 and 40 and can be used to buy a first home or save for retirement. It can be used to hold cash or stocks and shares, or a combination of the two.

Up to £4,000 each year can be invested each tax year until age 50 - this counts towards the overall ISA allowance. The Government adds a 25% bonus to the savings, up to a maximum of £1,000 per year.

Savings can be withdrawn without a tax charge at age 60 or over or (subject to certain conditions) for buying your first home. A 25% charge applies to withdrawals or transfers to another type of ISA before age 60, unless you are terminally ill with less than 12 months to live. There is also no tax charge on withdrawals following the death of the individual although the funds form part of the individual's estate.

Although a Lifetime ISA can be used for retirement provisions, there are concerns that it could be used as an alternative to pension provision, with the risk that savings could be lost in the short term if funds are withdrawn.

A similar Help to Buy ISA was available between 1 December 2015 and 30 November 2019, allowing a first-time home buyer to have their savings boosted by the government by 25% up to a maximum of £3,000. It is possible for someone to have both types of ISA, but the Government bonus from only one of them can be used.

Junior ISA
The Junior ISA works in a similar way to the adult ISA, but the yearly allowance is lower (£9,000 for the 2021/22 tax year) and there are only two saving options; namely the cash Junior ISA and the stocks and shares Junior ISA.

It is available for children under the age of 18. Children aged 16 and over can take out a Junior ISA on their own (or they can take control of their ISA when they reach age 16), but they cannot make any withdrawals until age 18. If a child is between the age of 16 and 18, they can take out an adult ISA as well (but only if it is a cash ISA).

A transfer cannot be made between a Junior ISA and an adult ISA. A Junior ISA automatically becomes an adult ISA at age 18.

Owning a business
Business owners or entrepreneurs may use their own business as a source of capital or income in retirement. By investing and reinvesting they can create a business which can either be sold at retirement or, if it is a company, they can continue to share in the success of the company by holding shares and being paid a dividend.

There are retirement reliefs available to people who sell a business to retire, which can make it an attractive proposition. However, it can be risky because using a business in such a way means that if the business does not succeed, then there may be no retirement income either.

Collections
Some people with a special skill or interest can use that skill or interest to make collections of items such as:
- wine;
- stamps;
- art;
- antiques.

These are non-income producing assets, but, through regular purchases, they can be used to accumulate capital. They can be sold at retirement and the proceeds reinvested for income, or they can be sold regularly during retirement to provide an irregular income.

It is expected that this type of investment, which is in effect investing in commodities, would be in addition to other asset types and not the sole basis for retirement provision.

Other Provision
There are several other ways of providing savings and investments for retirement, available to individuals who wish to do so. These include stocks and shares, bonds, property, unit trusts, **OEICs** or Investment Company with Variable Capital ("**ICVC**"), investment trusts, infrastructure investments, private equity, foreign currency, commodities, derivatives and the like. There are also target date, absolute return, diversified growth, pooled investment and hedge funds. These alternatives are described in more detail in the Investment module, as they are available as much (and sometimes more easily) for pension schemes and trustees.

INVESTMENT

Investment Considerations
When considering the way in which the investment portfolio is constructed, the provider of the product, or in the case of a pension scheme the trustees, will be concerned about the:
- diversity of the portfolio (diversity reduces the risk associated with holding a small number of stocks, which may perform badly);
- level of income;
- price variability of the asset (volatility);
- marketability of the asset; and
- “opportunity cost” of investing in one type of asset when better returns may be available elsewhere.

Diversification in investments is important, e.g. concentrating investments in a similar industry to the employer will increase the risk of underperforming if there is a downturn in that industrial sector.

Before constructing a portfolio of assets to meet particular objectives, e.g. to invest for capital growth, or to invest for income, or to invest for a specified level of total return, certain issues need to be considered.

The most important of these are:
- the level of risk the investor is prepared to take;
- whether to use active management or passive/index tracking;
- matching assets to liabilities;
- measuring performance; and
- for trustees only, the interests of the employer and the member.

Generally, the greater the expected reward, the greater the risk, and all investments are a trade-off between risk and reward.

Active investment management
This is the use of a human element, such as a single manager, co-managers or a team of managers, to actively manage a fund’s portfolio. Active managers rely on analytical research, forecasts and their own judgment and experience in making investment decisions on what to buy, hold and sell. They aim to achieve, in the long term, out-performance relative to a suitable benchmark.

Passive investment management (also referred to as index tracking)
This is an investing strategy that tracks a specified index or portfolio, often a market-weighted index. The most popular method is to mimic the performance of an externally specified index by buying an index fund. By tracking an index, an investment portfolio typically gets good diversification, low turnover (good for keeping down internal transaction costs), and low management fees. With low fees, an investor in such a fund would have higher returns than a similar fund with similar investments but higher management fees and/ or turnover/transaction costs.

Passive management is most common on the equity market, where index funds track a stock market index, but it is becoming more common in other investment types, including bonds, commodities and hedge funds. For example, if an investment is to be made in UK equities, then it could be made in a fund that tracks the FTSE All Share Index. This will give a broad spread of investments across the whole of the UK stock market (over 800 shares). If a manager actively seeks to outperform the index, then they will select fewer stocks, which they hope will outperform the index.

Defined Benefit Provision

For DB schemes, the investment strategy aims to ensure a scheme's assets are sufficient to cover its liabilities as they become due. The trustees will need to take into account the amount of the existing assets, the contribution levels, and the employer's and their own attitude to risk. As the employer will be required to contribute more if the scheme is underfunded, the strategy will impact on the employer.

The trustees will work closely with the employer to come up with an appropriate investment strategy. This is because the investment strategy will influence the amount and timing of contributions that the employer, who provides the financial backing, may need to pay to the scheme. For instance, a low-risk investment strategy might result in the need for higher employer contributions immediately while a high-risk investment strategy may lead to higher and potentially unexpected contribution requirements in the future.

Investment and the Employer Covenant

The trustees should consider how different strategies may affect the scheme's funding position, the employer's plans for sustainable growth and the employer covenant. The employer covenant is the willingness and ability of the sponsoring employers to meet their scheme funding obligations, and in particular to do so when investment performance has been poor. The investment strategy should be consistent with:

- the funding objectives;
- the appetite for risk, based on the funding objectives and the level of employer covenant and tolerance to risk;
- the scheme's liquidity needs; and
- the trustees' assessment of the employer's position and any plans they have for sustainable growth (including how these might strengthen their covenant).

Db scheme trustees need to know how much money their fund should contain today to meet the future pension promises to their members. For this, a detailed analysis of liabilities is required. The liability profile will depend on the demographics of the current and past employees, their age and sex, and salaries (for active members) and pensions (for deferred members and pensioners).

Most Db schemes carry out some asset/liability modelling to help determine what investments are needed to match liabilities. The liability profile is analysed against a range of asset portfolios with different risk/return profiles. Many schemes have traditionally skewed their asset allocation towards equities, in the search for higher returns; this has the potential to produce a larger fund, but also has the risk of a smaller fund if market conditions deteriorate.

Because of the longer timescale for investing benefits for active members, and the need to recognise their pensions may increase in line with pay rises, equities are generally reckoned to be a suitable investment for these liabilities. So, a scheme with a high proportion of actives is likely to have a large equity element in its portfolio. A more mature scheme, with a larger proportion of pensioners and deferred members, will more probably have its portfolio mainly in gilts and other bonds, since these are a less volatile source of income and capital growth which will meet the known liabilities.

Small Schemes

Trustees of small schemes often invest their pension contributions in insurance contracts. Until a scheme's assets reach a certain size, the costs and difficulties associated with benefit administration, payment of benefits and legal aspects usually outweigh investment considerations. With an insured scheme, the insurance company takes care of all these matters, and all the contributions are paid into the contract. When a scheme's assets grow beyond a certain size, the trustees will consider alternatives to insurance contracts.

Surplus and Deficit in DB schemes
Most DB schemes will aim to hold a small surplus in their assets over liabilities, which gives them a cushion to manage unexpected fluctuations and shortfalls in funding. Schemes in surplus also have more scope to follow a higher risk/return strategy, and a surplus may allow the trustees to pay discretionary benefits.

Many DB schemes, however, are in deficit, where the assets are not enough to cover the liabilities. The trustees are more likely to follow an investment strategy that is closely matched to the scheme's liabilities in this scenario, as the scheme is less able to withstand dips in asset values. Investments providing growth can be added to matched liability assets, to try to reduce the funding gap, but the risk of this would need to be taken into account.

If the deficit is small, an increase in employer contribution may close the gap in funding, but a larger deficit can cause problems. This will affect the employer's finances, as it must reflect the funding level of its DB pension scheme when completing its accounts. One of the effects of this is in respect to its credit rating, which affects the PPF risk-based levy, which all DB schemes have to pay. It will also mean the employer has to increase its contribution level significantly (and maybe also the members' contribution rate).

Large deficits may also bring about a higher level of regulatory scrutiny, which also increases costs.

Change to Liabilities in DB schemes
Increasing salary levels and consumer price inflation lead to an increase in DB fund liabilities. For a scheme to remain viable during any period of inflation, its assets must stand a good chance of increasing in line with its liabilities.

A rise in the rate of return on investments is likely to reduce the liabilities of a scheme.

Interest rates also affect the liabilities of a DB scheme. When rates are lower than was expected, assets do not grow at the predicted rate, and hence a shortfall against liabilities can emerge.

DB schemes have had to deal with increasing life expectancy in recent years. In 1840 average adults lived to around 40, while nowadays they would expect to reach 80 or beyond. There was a marked acceleration of life expectancy from the late 1990s. Increases in life expectancy lead to additional fund liabilities, as a scheme has to pay out benefits for longer.

Payment of Benefits from DB schemes
Where current contributions to the scheme exceed benefit payments out (pensions and cash lump sums), the benefits are usually paid out of the contributions before they are invested. Young schemes, with few pensioners relative to the number of actives, would be in this position.

Most schemes, though, need to supplement contributions with regular disinvestments, to cover the benefits being paid out. This happens when there is a high proportion of pensioners to active members. In these circumstances, trustees should consider holding investments which generate a level of income without the need to sell assets. The most reliable sources of income are gilts, corporate bonds and cash - equities are less suitable because dividend levels vary, and they usually provide less income than bonds and cash, as they are more about capital growth.

Managing risk in DB schemes
Many Db schemes undertake exercises to manage the risk of liabilities becoming greater than the scheme assets. These exercises can include some of the following, which aim to lower the scheme's liabilities.

- Enhanced transfer value exercises provide members with higher transfer values if they agree to move their benefits out of the scheme.
- Trivial commutation exercises offer members with small pensions the option of exchanging their benefits for a one-off lump sum. No further benefits are then payable from the scheme.
- An exchange may be made for pension increases, where members with pensions accrued before 1997 with increases are offered a higher pension in return for no further increases to these benefits.

Statement of Investment Principles ("SIP") for both DB and DC schemes
All occupational schemes with 100 or more members must have a SIP. This sets out an appropriate investment strategy and investment objectives.
The SIP must be reviewed every three years, or whenever there is a significant change in investment policy. For Db schemes the SIP must include the trustees' policy on:
- choosing investments;
- the kinds of investments to be held, and the balance between different kinds of investment;
- risk, including how risk is measured and managed;
- the expected return on investments;
- the realisation of investments;
- the extent to which, if at all, they take account of social, environmental or ethical considerations when taking investment decisions; and
- using the rights (including voting rights) attached to investments if they have them.

Additionally, the SIP can cover the investment governance structure, investment beliefs (if any have been developed) and investment objectives, risk capacity and appetite, the long-term journey plan (if one has been developed) and short-term milestones, the strategic asset allocation, any strategic liability hedge ratios, cashflow management plans, details of fee structures and details of how the investments will be monitored.

The SIP for DC schemes with 100 or more members will differ from one for a DB scheme. An appropriate investment strategy and investment objectives for all investment options, including the default strategy, should be set. The SIP would set out information such as the investment objectives and how investment decisions are made. The employer would also be consulted, and decisions taken would be reviewed regularly.

The trustees then regularly review the investment strategy laid out in the SIP, and the objectives for all investment options, including the default strategy. This ensures that appropriate investment options are available to suit members' diverse profiles and needs. Employers and trustees may choose to work with scheme providers and advisers, to ensure an appropriate range of investment options is available to those concerned.

There are new reporting requirements for trustees of DB and DC schemes, from 1 October 2021, relating to climate change governance. The requirements will initially only apply to certain types of schemes.

Defined Contribution Pensions
In the case of DC schemes, it is the members themselves who take the risk and so have the power to shape their own investment plan. However, employers and trustees should offer clear information about investment options to help members understand investment strategy and the interaction between risk and return in order to help individuals make informed choices.

In a trust-based DC scheme, trustees need to ensure that suitable investment options are offered, including a default strategy, to help ensure members receive a good outcome for their pension.

Choice of funds and default strategy

The default strategy, for members who do not want to choose their own investments, is a legal requirement if the employer is using the scheme for automatic enrolment, and for a stakeholder scheme.

The majority of members use the default strategy (either through active choice or by making no choice), which leaves the investment decisions with the trustees. Between 80% and 90% of all DC scheme assets are invested in a default fund.

A default fund may be a low-risk way to invest but, although it will be chosen to suit the majority of members, it may not be suitable for everyone. In designing a default strategy, DC trustees take into account the needs and demographic profile of the membership, as well as the interests of active and deferred members.

When choosing investments, the trustees should devote sufficient time to:

- understanding the objective of each fund;
- understanding fund costs and charges; and
- ensuring the number and risk profile of funds offered as an alternative to the default strategy meets the needs of the membership.

Funds are likely to cater for different attitudes to risk, as well as providing exposure to different sectors and parts of the world. Common examples could be actively or passively managed equity, property and bond funds. They will often also offer a balanced managed fund which, to diversify further, covers investments across different asset classes.

Where a workplace has a diverse employee profile – especially in terms of age – employers and trustees may want to ensure the scheme offers a suitable number of funds to fit different risk profiles and requirements of members.

Life Styling

Employers and trustees should ensure that the default investment funds are appropriate and that the risk is reduced as the member approaches retirement.

Some default funds have a “lifestyle” option, and stakeholder schemes are legally required to have a default fund with life styling. Here, as members get closer to retirement, their savings will be moved automatically, from equities initially (to offer the best opportunity for growth, as shares have historically outperformed other assets), into investments which are less volatile, such as bonds and cash.

This “glide path” approach, which targets a particular date and changes assets gradually over the years to retirement, can help to protect savings from unexpected falls in fund prices that could reduce the pension at retirement. However, it may also mean funds are moved at a time when they lose out on future investment growth, so they do not maximise the growth potential as retirement approaches. Thus, there is still investment risk in life styling.

There is some debate about when the assets should be switched from equities to bonds, but the range is typically 3 to 10 years before benefits are planned to be taken. However, if a member’s plans change, which they often can, this can prove to be problematic.

Members need to think about how closely the default fund, with its long-term investment aims, matches their own needs. Schemes will give forecasts of how much a member may expect to live on in retirement, based on age, past contributions, investment performance, and the period remaining for future contributions. Many insurance companies offer online tools, which enable scheme members to run their own projections based on their target income in retirement.

People tend not to know when they will retire, but they do think it will be a gradual process, rather than a cliff edge, and they are not sure how they will use any assets they have. This reflects the introduction of pension flexibilities in 2015. Default funds need to be designed to address this uncertainty, rather than optimised for any single scenario. The default strategy should no longer target cash or an annuity on a particular date but should provide an appropriate level of risk for individuals, based on their stage of life; it should not be overly sensitive to the precise timing of a pot of money. The "glide path" approach may or may not be appropriate, depending on the member's circumstances.

Annuities and drawdown

In DC schemes, living longer can mean there is a risk of funds running out before the individual dies. Using income drawdown alone can be difficult to manage and, even though there is no longer a requirement to do so, buying an annuity may be the best way to provide for a lifetime income.

There is, though, an expectation that one default option will provide assets which roll over into flexible drawdown when a member is ready to start drawing on those funds. Members want some simple, limited and intuitive choices alongside the default, but more as a safety precaution than something they are actively likely to use.

Investment choices

If members decide to invest in any default fund or lifestyle fund offered by an arrangement, it is important they make sure its aims match their own. Even where members decide it is right for them, they should review their choice from time to time to make sure its aims continue to match their own.

Informed choice is at the heart of effective decision making - monitoring and communicating investment performance can help members find the right investment strategy for their circumstances and thereby to hopefully get better returns.

What Types of Assets are there?

Investment Categories

Assets - such as equities, bonds, property and cash - can be broken down into two main types, known as "real assets" and "monetary assets".

Equities, property and index-linked securities are "real" assets. This means that, over the long term, they should at least retain their value (in terms of purchasing power), even if inflation is high. The increase in value in a company's shares can be due to the company producing higher profits, or to general factors influencing industry everywhere. Equities have historically produced a return in excess of inflation, and so they may be chosen to meet the need for capital growth over a long period. The price of property is set by demand, which increases as profits increase; as profits increase more when there is inflation, property prices are indirectly linked to inflation. Index-linked securities are designed so that the investment value is protected against price inflation, as is the income stream they produce.

Cash and bonds (when not index-linked) are "monetary" assets. There is no link between inflation and the expected performance of these assets, which is expressed in monetary terms.

Investment classes

Equities
In the UK, equities are known as “shares”, while in the US they are known as “common stocks”. In most major companies, and thousands of smaller ones, they can be bought and sold.

Shares can be classified according to industries (e.g. electricals), the size of the company’s capital or its geographical location, among other things. Their value is assessed according to general influences within the groups to which they belong.

The shares of larger companies are well researched and can be dealt with easily and in large quantities. Much of the value of the company will be reflected in its share price. Smaller companies are less well known and may have some potential that is not reflected in the price.

Shareholders have voting rights and can influence the management of a company. Corporate governance, or activism, is a particularly important issue among large pension funds and investment managers as they seek to influence the management and development of the companies in which they have invested to get a good return for their scheme members/clients.

Equity shareholders are the ultimate owners of the company, and they have the opportunity to share in the increased success and value of a company. They are entitled to any profits remaining after the company has paid its expenses. Expenses include interest on borrowed money, rent and rates, salaries, costs of raw materials and services. Once the expenses have been paid, the company must then honour its obligations towards higher ranked shareholders. (This is explained in more detail under the sub-heading “preference shares”). It may also choose to put some investment back in the company for new plant and product development. After these commitments have been met the remaining profits are distributed as dividends quoted as so many pence per share.

However, equities do not carry any guarantee that an investor will see a return on their investment or even that the capital they have invested through their share buying activities will be safe.

UK Equities
Equity investments by UK-based pension schemes often contain a high proportion of UK equities, unless the scheme’s objectives are explicitly otherwise (for example to invest only in Japanese equities).

A spread of UK equities will, to some extent, diversify risk. Those who are trying to outperform the market (adding value in excess of a relevant index) will invest in a small number of companies, but with a higher risk. If the aim is to perform only at the level of the market, expressed by an index such as the FTSE All Share Index, then it is possible to have a shareholding whose investment objective is to do just that.

Overseas Equities
Overseas or international equities are the ordinary shares of companies whose prices are quoted overseas. This is confused by the fact that some UK companies only have their share prices quoted overseas and vice versa.

Although equities exist in most democratic countries, foreign nationals cannot always buy them. The FTSE/S&P Actuaries World Indices, published in the Financial Times, show the names of the countries in which most UK investors are interested.

The main overseas markets are:
- North America (US and Canada);
- Europe (ex-UK);
- Japan;
- Asia-Pacific developed (Hong Kong, South Korea, Australasia etc.);
- Emerging markets (including China);
- Frontier markets; and
- European countries such as:
  - Germany
  - France
  - Spain
  - Switzerland
  - The Netherlands.

Investment in overseas equities provides diversification of assets and therefore, reduces risk. This is because equities in markets overseas do not necessarily perform in the same general way as those in the home country, mainly because they are not necessarily exposed to the same economic climate.

For example, until recently, shares in Japan had not performed well for about ten years, while the country suffered from over-manning in industry and deflation. This contrasts with shares in the US where a benign economic climate encouraged good performance for US stocks over the same period.

Diversification also allows access to sectors and stocks, for example semi-conductors, which are not represented in the UK. It also allows investors to take a stake in companies which are unique, or which are similar to ones in the UK but which have better potential or present an opportunity to invest in a stronger economy than the UK in the long term.

Other considerations

Overseas investment poses a number of other considerations:
- reporting standards in other countries may be lower;
- the quality and availability of research in the activities and profitability of the company may be limited;
- dealing systems may be different;
- there may be different attitudes to Stock Market investment - for example, few Germans hold shares directly;
- the country’s political stability may be an issue;
- unlike in the UK many companies do not hold a register of the owners of their shares. Instead, ‘bearer certificates’ are issued and possession of them indicates ownership. These certificates are therefore valuable and have to be safeguarded;
- risk where liabilities are in sterling and investments denominated in a foreign currency.

Returns and yield

Dividends

One way in which companies can distribute their profits to shareholders (after other commitments have been met) is in the form of dividends. A dividend is a cash payment expressed in pence per share held. Dividends are normally paid in two six-monthly instalments: an interim dividend followed by a final dividend. The total dividend reflects the company’s profitability for the complete financial year, but dividends can be paid out of profits from previous years and sometimes directors will hold back profits from good years in order to be able to offer dividends in poor years.

Growth

In addition to dividend income, investors can benefit from capital growth in the price of the shares they hold. Share prices change according to the price buyers and sellers are willing to trade at on the stock market at any particular time, and hence can go up or down. Shareholders can realise any capital growth of their shares by selling them.

Some companies have moved towards reinvesting their profits in the company and instigating share buybacks. This is where the company buys back its own shares, thereby reducing the number in circulation and enhancing any dividend or earnings-per-share ratio, which, in turn, should increase the share price. Other more ingenious methods of providing value for shareholders, for example demergers or sales of subsidiaries and cash returns, have also been devised.

Yield

One of the ways in which the value of an equity can be judged is by its ‘yield’. Yield is income produced expressed as a percentage of the capital value of that investment. Historically, overseas equities have produced lower yields than UK equities.

Types of share

Ordinary shares

Ordinary shares make up the majority of shares traded on the stock market. Ordinary shareholders receive any distributed profits after obligations to preference shareholders have been met.

Preference shares

Preference shares make up a small percentage of the total market in shares. A preference share entitles the holder to a preferred fixed dividend. For example, if it is a 6% preference share then the company must pay a 6% dividend on that share before the ordinary shareholders receive any payment. On the other hand, the ordinary shareholders may receive much more than the preference shareholders if a large dividend is declared. However, if the company does not declare a dividend, then the preference shareholders receive nothing.

Some preference shares are “cumulative”, meaning the holders retain the right to a dividend payment for any year when the company does not pay a dividend.

Redeemable preference shares

A company can issue shares, which are redeemable at the option of the company or the shareholder. There are rules regarding the sources of funds that can be used to buy back redeemable shares. Shares are treated as cancelled when they have been redeemed and the issued share capital is reduced accordingly.

Fixed-interest securities/bonds

The main types of fixed interest security/bond are:

UK

- those issued by the British Government, known as gilt-edged securities or “gilts”;
- local authority securities; and
- company debentures (secured against specific assets of the company or against its general assets), loan stocks and corporate bonds (no security is offered for these so they offer a higher rate of interest).

Overseas
- bonds issued by foreign governments and public bodies such as the World Bank; and
- bonds issued by foreign companies. These are expressed in foreign currency, usually, but not always, in the home currency of the issuing body. Investors need to take the exchange rate into account when assessing the worth of their investment.

The interest payments on bonds and the proceeds at maturity are set out in advance (although the bond issuer may not be able to meet these payments, and so may “default”). This is ideal for meeting pension benefits that are fixed in monetary terms, such as pensions in payment, with fixed rates of annual increases.

Fixed interest securities are given different names according to the length of time to their redemption:
- short dated: under five years to the redemption date;
- medium dated: five to 15 years to the redemption date;
- long dated: over 15 years to the redemption date; and
- irredeemable: no redemption date - these securities provide a perpetual stream of income.

Trading bonds
Whereas securities can be traded singly, government bonds, whether conventional or index-linked gilts, are normally quoted in “packets” of £100 nominal. This nominal value is referred to as “par”. The proceeds, in the form of interest (called a “coupon”) and capital redemption are known at the outset. A fixed sum in interest is paid each year and the government or company guarantees to repay the bond at a certain date at par.

Example:
For every £100 of stock originally issued, the Government-issued “Treasury 5% Treasury Stock 2025” would guarantee £5.00 each year in interest payments and the capital investment is repaid at £100 in 2025.

Note that if interest rates are higher than 5%, an investor would not expect to pay £100 for £100 nominal stock: the price should be less. Similarly, if interest rates are lower than 5%, the price of £100 nominal stock is likely to be more than £100. The investors still receive the £5.00 of interest each year on the £100 nominal value (although this may not be the amount they paid for the stock) and are repaid £100 even if less, or more, was paid for the bond. The total return, for capital and interest combined, is called the ‘redemption yield’, and the quoted price reflects current and future expectations for interest rates.

Marketability
The market in government bonds is very liquid; in other words, large quantities can be bought and sold easily and with low charges. The market in corporate bonds is less liquid. They usually offer a higher yield than government bonds and this can be seen as enough to compensate for the default risk (where a company goes insolvent, or is otherwise unable to meet the interest or capital redemption commitments). Corporate bonds are given credit ratings by agencies such as Standard & Poor’s, Moody’s or Fitch. These indicate the likely default risk, AAA or AAA (the letter codes used for ratings vary between ratings agencies) being the strongest rating, i.e. least likely to default. BBB or Baa ratings and above are known as investment grade; ratings of less than BBB or Baa are known as speculative grade.

Risk
Although there is a lower risk with this type of investment, there are pros and cons that should be taken into account. The major difference is that bonds (unless index-linked) are not a “real” asset because the return is fixed and not linked to inflation. Therefore, they may not adequately compensate for inflation during the period the bond is held. However, investment in bonds can be attractive in times of falling inflation, as the capital value will rise.

Bonds are quoted on the Stock Market. They fluctuate in value according to the trends and conditions in the economy, and the balance between buyers and sellers. Bond prices are higher when availability is limited (for example, because the Government is seeking to reduce its debt) but demand often remains high because investors are seeking a return to match their fixed monetary outgoings.

Index-linked securities
An index-linked security is a particular type of bond, normally issued by a government or a quasi-government body. In the UK they are called “index-linked gilts”, and “TIPS” in the United States. Both the interest payment and the redemption value are linked to a price inflation index (the RPI in the UK). If the level of prices at redemption had risen to twice its value at issue then the redemption price would be £200 for every “packet” of £100 nominal. The investment income and redemption proceeds are fully price inflation proofed provided that the investment is held until the redemption date.

Index-linked gilts issued by the UK government provide variable income to an investor, derived using the initial income and increases in the RPI, but they are also similar to fixed interest gilts as there is a guarantee of payment by government. There is a range of maturity dates for the issues available.

This inflation-proofed investment is a very suitable asset to match the liability for pensions in payment, which provides increases related to the cost of living. A pension scheme will have other liabilities that are linked to working employees and their salaries, and real assets are more appropriate to match these liabilities.

The index-linked investment will produce a guaranteed “real” return, and the benefit of this guarantee may result in these investments trading at a higher price as investors value this certainty. As the level of price inflation in the future is unknown, the total return is unknown. In terms of risk in nominal terms (i.e. not allowing for inflation), therefore, this fits somewhere between an equity, where no return is known for certain, and an ordinary bond where the exact terms are known on purchase.

Insurance with-profits contracts
The with-profits approach seeks to provide a good level of return from a mixed pool of assets, but without the investor being exposed to the volatility associated with direct investment. With-profits policies aim to smooth the returns over the life of the policy by not fully declaring actual returns, but rather keeping back a reserve in good years and providing a bonus in weaker years.

Traditionally, with-profits policies that were used to fund DB schemes started from the premise that in return for a premium, a given amount of either pension or cash was guaranteed. A policy that offers a guaranteed pension is called a “with-profits deferred annuity”. Latterly, with-profits policies were sold on a unitised basis, where investors buy units in the fund. The value of these units then change over time and the investor may be credited with additional units, depending on how the bonuses are applied.

A final share of profits or terminal bonus is often added when benefits are due to be paid under the contract. The amount of terminal bonus can be varied by the provider at any time and is not guaranteed.

In setting rates of reversionary and terminal bonuses, the insurer has to strike a balance between investing in assets with the potential for higher returns and achieving the promised level of guarantees. If a high proportion of the relevant assets are required to provide the guaranteed levels of benefits, this could lower investment returns and consequently lower pay-outs to policyholders.

Managed funds
A managed fund is an investment contract under which an insurance company offers participation in pooled funds. Increasingly, insurers set their investment services up as separate asset management companies, or offer external links to other managers. Technically, such a managed fund is an insurance policy run by a life company, enjoying tax advantages similar to other pensions accounts in the company.

Cash

Risks of holding cash
The problem with cash is that during periods of high price inflation, it may not retain its "real" value and will be seen as a poor investment (as the interest rate may be lower than the rate of inflation). Holding large amounts of cash for any period of time can be a high risk after considering inflation.

On the other hand, cash is a good diversifier, and very safe in nominal terms (i.e. ignoring inflation) in times of uncertainty or when stock markets are falling.

Cash may be held with traditional banks and building societies, or with internet banks, postal deposit takers, National Savings or the Post Office. Shared cash funds are available from unit trust companies, which seek better returns by consolidating deposits to receive a higher rate of interest.

Property

Direct ownership
Direct ownership in property involves the purchase of an actual building by the investor for rental, with the investment returns being made up of the rental payments and any capital gain on selling the building in future.

Such an investment is usually in a large commercial property – offices, retail or industrial (warehouses and factories) - and hence usually only larger pension funds or institutional investors consider direct ownership. Furthermore, holding a small number of properties directly can concentrate the investment risk, as if the property is not rented then there is no income generated from the investment.

The time spent in purchase and sale of a property is usually much greater than that for quoted securities. This means that property is usually regarded as a long-term investment. The income it can produce and the financial strength of the tenant paying that income largely determine the value of a property. Other considerations are location, communication links, parking facilities, the prestige of nearby tenants, and size. External factors such as planned new communication links, development areas and the impact of European Union decisions can also have a bearing on value.

Property Unit Trusts
The benefit of investing in property via a collective investment scheme, such as a unit trust, is that smaller investors can gain exposure to property investments without having to commit large sums of money. Additionally, such pooled funds can invest in many properties, and hence the risk of generating no income due to the properties not being rented is reduced. When investing in a unit trust, there is no need to employ a property manager, but the investor has no control over the type and spread of assets in the trust once they have invested. However, property unit trusts will often have stated criteria for the types of properties in which it will usually invest.

Additionally, a property unit trust is subject to a management charge on purchase, ongoing management expenses, and trustee and professional fees. These tend to be much higher in aggregate than the cost that might have been incurred through investing directly in property. The unit price depends on individual valuations carried out by professional valuers. These are only carried out from time to time so it is difficult to know whether the unit price is a reliable value indicator for the underlying investments.

Liquidity is not often a problem, but if a large number of investors wish to dispose of their holdings at the same time the provider can invoke a legal power to delay payment. This may happen if the property market is not particularly buoyant or if a large disposal would threaten the unit price.

Marketability

The purchase and sale of property is time consuming. This compares unfavourably with shares and bonds, which can be sold immediately with settlement within a few days. Direct property investment therefore tends to be very long term, and to be an illiquid asset.

Risk

Property is subject to fashion as different sectors fall in and out of favour, and it is also cyclical. This is partly because of the actual time it takes to build a property and also because it is a long-term commitment. When property is booming, more developers come into the market. Two or three years later, there will be an influx of new property available, and this may just be at a time when the economy is cooling down, so leading to less demand and property prices and rents falling.

However, because the property cycle does not correlate with the stocks and shares cycle (it often performs well when shares are performing badly and vice versa) it is a good diversifier in a balanced portfolio.

Target Date Funds

Target date funds are designed to offer a convenient way to invest for a person in a DC scheme expecting to retire around a specified date. The fund pursues a long-term investment strategy, using a mix of assets classes (or asset allocation) that the fund provider adjusts to become more conservative over time. Asset allocation is one of the most important factors in long-term portfolio performance.

Target date funds, designed to help DC investors avoid some of the most common investment mistakes, include features like:

- diversification across asset classes. The funds invest in a mix of classes, including equities, bonds and cash.
- avoiding extreme asset allocations. Some young workers invest very conservatively, by allocating almost all their accounts to fixed income investments, while some nearing retirement invest aggressively, with high equity allocation. Target date funds follow professionally designed models to eliminate such extremes.
- automatic rebalancing. Funds are rebalanced periodically to maintain their target asset allocation, so that swings in the market do not throw an allocation off course. Systematic rebalancing tends to improve a portfolio’s long-term performance.
- automatic adjustment for changing risk profile. The asset allocation is adjusted to become more conservative over time, to account for factors that affect an investor’s risk profile - a shorter time horizon, fewer chances to make contributions to savings, and greater sensitivity to capital market swings.

Fund providers typically offer funds with target dates spaced at five or ten-year intervals, to meet the needs of investors across a wide range of ages. Thus, a person anticipating retirement in 2039 could invest in a 2040 fund, while one expecting to take benefits in 2023 might choose a 2021 fund, a 2025 fund, or a combination of each.

As already explained in the section on DC investment considerations, the target date fund may follow a “glide path” in its asset allocation, to become more conservative over time. Since discussion of asset allocation usually focus on the percentage of the portfolio invested in equities, the glide path reflects its declining proportion of equities as it approaches and passes the target date. While glide paths differ, based on the assumptions and calculations providers use in designing their funds, all glide paths provide more exposure to equities for younger investors, and more to fixed income and cash for those near retirement. Some funds also actively manage asset allocations along the glide path, within present limits, to respond to prevailing market conditions.

Pooled Investment Funds

Pooled investment funds - also known as collective investment schemes - are a way of putting sums of money from many investors into a large fund spread across many investments, managed by professionals. Investing this way can potentially be easier and less risky than buying shares in individual companies, and there are many funds from which to choose. The range offers different strategies, including high income, capital growth, or both.

Reasons to invest through a fund include:

- spreading risk. Even with a small amount to invest, funds can be diversified into many different types of asset. If one investment does badly, it may not do too much damage, since the fund has many others on which to fall back;
- reduced dealing costs. By pooling money with other investors, each may make some savings, as costs are also shared;
- less work for individuals. The fund manager handles buying, selling and collecting dividends and income (though there are charges for this);
- professional fund management. Fund managers with specialised knowledge make the decisions about when to buy and sell assets.

Unit trusts

One type of pooled investment is unit trusts. In these, investors hold units in the collective fund, which can be bought from the trustee or fund manager, and sold back to it. The price will vary according to the performance of the underlying assets held, reflecting the net asset value ("**NAV**") of the holding, and there may be a difference in the purchase and selling prices. Unit trusts are "open-ended", meaning that there is no limit to the number of units available. As more (or fewer) people invest, more units are created (or the number is reduced). Most unit trusts offer the alternatives of a regular payment of income or of gains being accumulated for the investor.

Investment trusts

Investment trusts, by contrast, are companies in which investors hold shares that are publicly traded on a stock exchange. An investment trust has only a specified number of shares available; it is "closed-ended". The buying and selling prices are consequently set by the market, and are linked only indirectly to the NAV of the underlying investments. Shares often trade at a discount to the NAV, although they may sometimes trade at a premium.

Investment trusts normally distribute their gains in dividend form, like any other company. As investment trusts are companies in their own right, they are not bound by the same investment rules as unit trusts, giving the managers more flexibility.

ICVCs/OEICs

A third type of pooled investment is the investment company with variable capital ("**ICVC**"). These - often known by their original name of open-ended investment companies (see "**OEICs**" above) - operate in a similar way to unit trusts, as they are open-ended, except that the fund is run as a company. Investors own shares in the company, which will be bought from the fund manager and sold back to it, and there is no difference between the sale and purchase prices (the manager takes its fees through a management charge, and perhaps a levy when the shares are purchased). Shares are created and cancelled, but they still directly reflect the value of the investments.

ICVCs are often structured so that a top-level fund holds sub-funds, offering different share classes.

Derivatives
Derivatives are a type of financial instrument that derives its value from the price of an underlying asset, such as an interest rate, equity, commodity or currency. Instead of having to buy or sell the underlying asset, a fund manager can buy or sell a derivative linked to it, often at a lower cost, and still take advantage of movement in the asset price. Derivatives may provide exposure to a market or sector. Many different types exist.

- "Futures" are contracts under which a buyer agrees to purchase an asset at a specified future date, at a price agreed today. These are standardised products, traded on an exchange.
- Similar to futures are "forwards", but they are customisable, and traded over the counter ("OTC"), that is, through private agreements rather than via an exchange.
- "Options" are a type of derivative that gives the buyer the right, but not the obligation, to buy (a 'call option') or sell (a 'put option') an underlying asset at an agreed price on a specified future date.
- "Swaps" are agreements under which two parties will exchange (swap) either single payments or a series of payments in the future. While some swaps are complex, most involve exchanging a fixed payment for a floating series of payments. Swap contracts can be tailor-made to each investor's specific requirements. They are traded OTC, like forwards, rather than on an exchange. Banks, money making institutions and other financial organisations are the main operators in the swaps market.
- A "contract for difference" is a contract between two parties, whereby the seller agrees to pay the difference between the value of an asset now and its value at the contract expiry. This enables fund managers to benefit from changes in the price of an asset without actually owning it.

Commodities
Commodities may be part of investment portfolios, such as for pension schemes. As well as providing attractive returns, commodity prices are largely uncorrelated to those of other investments, so adding to diversification in a portfolio.

Commodities may be "hard" or "soft". Hard commodities include precious metals, industrial metals, oil and coal, while soft refers to agricultural products, such as wheat, coffee, sugar and cotton. Investment in these assets is rarely done directly, as taking delivery of the goods and selling them on is impractical, so most investment is made through commodity derivatives, particularly in the futures market.

Commodity prices are broadly determined by supply and demand and can be volatile and hard to predict. Thus, soft commodity prices can be affected by adverse weather, while oil prices are influenced by global economic activity and political concerns, and gold is linked to inflation, political uncertainty and the activity of central banks.

Infrastructure
Infrastructure investment facilitates the provision of essential services. These support economic growth, increase productivity, and underpin society. The growing reliance on private sector finance by governments faced with austerity and increased budgetary constraints has presented increased investment opportunities in this asset class. The main attractions for trustees are the long-term stable cash flows and, typically, lower volatility than many other asset classes. Infrastructure has both bond-like and equity-like characteristics, with a vast array of differing investment opportunities.

Ethical and Socially Responsible Investment
Any investment strategy which seeks to consider both the financial return and social good will qualify as ethical, socially responsible, sustainable, green or socially conscious investing. In general, such investing encourages corporate practices that promote environmental stewardship, consumer protection, human rights and diversity. They may avoid businesses involved in alcohol, tobacco, gambling, pornography, weapons, the military or fossil fuel production.

Diversified Growth Funds
These are funds that invest in a wide variety of asset classes, to deliver real capital appreciation over the medium to long term. Unlike most traditional pooled funds, the fund manager is given a task in terms of the end result, but considerable freedom in how to achieve it. Usually, the returns are targeted from a range of different asset classes, with the manager using its skill to switch tactically between classes, as well as within each class.

There is a lot of variation among these funds, but typical aims are for a certain level of return over inflation, or above cash. The long-term aim may be to produce a similar level of return to equities, but with about two-thirds the level of volatility.

Equities frequently make up the majority of the investments, but asset classes may include global and emerging market equities, private equity, (investment grade) corporate bonds, high-yield bonds, emerging market debt, property, cash, commodities, infrastructure and hedge funds. The diversified growth funds can be used as potential replacements for equity funds within a DB scheme's investment strategy.

Absolute return funds
In simple terms, an absolute return fund, like a diversified growth fund, aims to generate positive returns in all market conditions. This contrasts with a traditional equity fund, which seeks to generate returns relative to the equity market. The concept behind absolute return funds is that they seek to mitigate these fluctuations and so aim to give investors a clearer idea of what absolute returns they might expect, at lower levels of risk than traditional funds.

Of course, merely generating a positive absolute return is not enough to entice most investors. Therefore, an absolute return fund will often have an annual target that it aims to achieve, or exceed, which is typically set at 2-4% above the cash rate, or above inflation. The cash rate in this case is usually measured by LIBID, the interest rate which banks pay on deposits from other banks.

Private equity
Private equity consists of investors and funds that invest directly into private companies (i.e. those not listed on a stock exchange), or conduct buyouts of public companies that result in a delisting of its shares. Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions, or to strengthen a balance sheet.

Investing in private equity tends to offer the investor the opportunity to generate higher absolute returns, while improving portfolio diversification. Managers of private equity funds seek absolute returns and are highly motivated towards achieving net cash returns to investors.

The majority of private equity consists of institutional investors and accredited investors who can commit large sums of money for long periods of time. Private equity investments often demand long holding periods to allow for the turnaround of a distressed company or a liquidity event such as an initial public offering (IPO) or sale to a public company.

Hedge funds
A hedge fund acts as a private investment fund that is usually targeted towards very wealthy individuals and large-scale professional institutions such as insurance companies or pension funds. A hedge fund is very flexible and hedge fund managers aim to invest in anything that they believe will make profits. Unlike other types of investment fund, a hedge fund does not rely primarily on the performance of the stock markets. For example, hedge fund managers may look to derive value by seeking investment opportunities in a bankrupt or merging company. Similarly, they may look to take a trading position based on the way that they feel that specific currencies or commodities will move.

Hedge funds do not necessarily invest in the underlying asset classes, using instead financial instruments such as futures and options. As markets move up and down, so do the financial instruments, hopefully making returns for their investors.

The key aspect of a hedge fund is its very flexible nature that allows managers to invest in a variety of asset classes in a variety of conditions. However, this level of flexibility also presents a very high level of risk.

Currency
If an investor wants exposure to US equities, for all intents and purposes he must buy those stocks in US dollars. The implications of this are clear if you compare the returns from a benchmark index such as the S&P 500 in local currency terms against the returns in sterling during a period of exchange rate volatility. For example, if the S&P 500 index rises 10% over the course of a year, but the dollar weakens against sterling by the same margin, the net result for UK investors is a 0% return.

To combat this, investors can choose to 'hedge' their currency risk. This is often offered by fund managers trading in common currencies, especially on more frequently traded or larger funds, and it means that investors receive the return expressed in the local currency. Hedging is often achieved through using derivatives, such as a forward, a currency option or a currency swap.