Pensions Management Institute
ACHIEVING PENSIONS EXCELLENCE

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Core Unit 4 – Financing and Investing for Retirement Provision

Assignment 3 Notes

(Part 3 – Financial Regulation & Administration)
Recommended Time: 1 hour

1. **What are the objectives of the Pensions Regulator?**

5 marks

The Pensions Regulator is the UK regulator of work-based pension schemes and has the following statutory objectives.

Protection of members' benefits: this will be especially significant in relation to defined benefit schemes, where there is reliance on the employer covenant to provide the future contributions needed to pay for the promised benefits.

Administration: to promote, and to improve understanding of the good administration of work-based pension schemes.

Pension Protection Fund (PPF): to reduce the risk of situations arising which may lead to compensation being payable from the PPF.

Automatic enrolment: to maximise employer compliance in relation to the automatic enrolment requirements.

Sustainable growth of employers: to minimise any adverse impact on the sustainable growth of an employer in relation to defined benefit scheme funding. This additional objective was added in 2013, in response to concerns that there was a need for an objective to balance against protecting members' benefits, to help achieve balanced funding solutions which met the objectives of both trustees and employers.

(The relevant section of the Study Manual is Part 3, Chapter 1.3)

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2. **Briefly describe the restrictions imposed on occupational pension schemes by the self-investment regulations.**

5 marks

The Pensions Act 1995 and the Occupational Pension Schemes (Investment) Regulations 2005 impose a restriction on trustees investing in the sponsoring employer of the scheme. Trustees must not (a) invest more than 5% of the current market value of the scheme's assets in employer-related investments, or (b) invest in employer-related loans.

Employer related investments include:

- Shares issued by the employer or any other company in the group
- Land occupied or used by the employer
- Other property used for the purposes of the employer's business
- Units in a collective investment vehicle that holds an employer related investment
- Any premiums or payments from an insurance policy that is invested in the employer.

Since 23 September 2010, this 5% limit includes investments in the sponsoring employer made by collective investment schemes.

Schemes must monitor their employer-related investments and full disclosure must be made in the trustees' annual report if the aggregate amount exceeds the 5% limit.

The Regulations are relaxed in the case of small member controlled schemes, where investment no more than 20% of the market value of a scheme's investment portfolio and do not apply to one member arrangements.

(The relevant section of the Study Manual is Part 3, Chapter 1.5)

3. **What is the purpose of the Pension Protection Fund (PPF) and how does the compensation paid by the PPF to members of an admitted pension scheme differ from the benefits provided by that scheme?**

10 marks

The Pension Protection Fund (PPF) provides compensation to members of eligible defined benefit pension schemes in the event that a scheme's sponsoring company becomes insolvent and is unable to make the payments due from it to the scheme.

The PPF obtains its funding from a number of sources, including:

- Assets retained from the schemes for which it assumes responsibility.
- Annual levies from eligible schemes.
- Returns on its investments.
- Pension debt recovered from employers.

The levy payable by eligible schemes has a substantial element that is risk based; i.e. schemes deemed to have a higher likelihood of entering the PPF are required to pay higher levies.

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In order for the PPF to assume responsibility for a scheme, the scheme must meet the following conditions:

- It must be eligible (i.e. a defined benefit scheme or a defined benefit element of a hybrid scheme that is liable to pay the PPF's levies).
- It must not have commenced wind up before 6 April 2005.
- The employer must have become insolvent on or after 6 April 2005.
- There must be no chance that the scheme can be rescued.
- It must be unable to match the level of compensation that the PPF would pay if it assumed responsibility for the scheme.

A period of assessment is needed for the PPF to determine whether a scheme meets the latter two conditions. During this time, the trustees remain responsible for scheme administration and must continue to act in the interests of all its members. However, trustees will be monitored by the PPF, which has the right to comment on investment strategy. In addition, benefits payable will be limited to PPF levels of compensation. The assets are typically transferred to the PPF within one to three years after the insolvency event.

The PPF provides two levels of compensation:

1. Members who already have reached the scheme's normal retirement age or are in receipt of a survivor's or ill-health pension at the date the assessment period begins will receive 100% of the pensions they are being paid.
2. Members who are below the scheme's retirement age on the date of assessment will normally receive 90% of their accrued pension at the time. The maximum overall compensation that members can claim is capped at £33,678.38 p.a. at age 65 (as at April 2016 and after the 90% has been applied).

The part of this compensation that is derived from pensionable service on or after 6 April 1997 will be increased each year in line with inflation capped at 2.5%. This could, potentially, result in a lower rate of increase than the scheme would have provided.

The Pensions Act 2014 amends the cap calculations to recognise long service in a scheme. If a member has more than 20 years' service in a scheme, the cap will be increased by 3% for each full year to a maximum of double the standard amount.

(The relevant section of the Study Manual is Part 3, Chapter 1.4)

4. **What is the purpose of an event report to HMRC and what is the deadline for submitting it? Describe five examples of matters which require inclusion in an event report.**

10 marks

An administrator of a registered pension scheme must automatically provide HMRC with certain information, so that HMRC to monitor the activities of the scheme to ensure these are consistent with registered status and that appropriate tax is paid. An Event Report is one requirement, the others being:

- Accounting for Tax Returns
- Unauthorised borrowing reports
- Notification of a transfer of pension funds to a qualifying recognised overseas pension scheme
- Notification that they are no longer the scheme administrator.

The Scheme Administrator must provide an event report to HMRC giving details of certain events (which are set out in legislation and in the Registered Pension Schemes Manual - RPSM) that have occurred during the tax year to which the report relates. With one exception, the event report must be submitted to HMRC no later than 31 January after the end of the tax year to which it relates. A shorter deadline applies if the scheme has completed winding up. No report is required if there have been no reportable events.

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The exception relates to transfer payments made to qualifying recognised overseas pension schemes (QROPS), where schemes must report any such transfers separately to HMRC within 60 days of payment.

HMRC will impose a penalty on the Scheme Administrator of up to £300 if an event report is not submitted or is submitted late. Additional penalties of up to £60 per day can be imposed if there is further delay.

Examples of events that must be included in an Event Report are as follows:

Unauthorised payments: any payment that does not meet the conditions of payment set out by the tax rules is an unauthorised payment and must be reported. Such payments are subject to special tax charges on both the recipient and on the scheme, which HMRC need to monitor to ensure correct tax charges are levied.

Lifetime Allowance: a member's benefits are tested against the Lifetime Allowance (a benefit crystallisation event) and they have an enhanced lifetime allowance, enhanced protection or fixed protection, and their total benefits are more than the lifetime allowance.

Pension commencement lump sums: Payment of a pension commencement lump sum to a member with primary or enhanced protection and the lump sum is more than the maximum lump sum payable to a member without lump sum protection.

Scheme changes: certain changes to the scheme, for example if the scheme becomes, or ceases to be an occupational pension scheme.

Ill health pension: Payment of a serious ill health lump sum to a member who is a scheme employer, director of a scheme employer (or associated company) or connected to such a person.

(The relevant section of the Study Manual is Part 3, Chapter 2.2.1)

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5. **In the context of a pension scheme's financial statements, briefly describe:**

a) the four fundamental accounting concepts; and
b) the standard audit opinions.

10 marks

a) It is generally accepted that four concepts are fundamental, in so far as non-compliance with them would need to be stated - otherwise they are taken for granted. In the context of pension schemes, these are:

Going-concern: The scheme is assumed to be continuing for the foreseeable future.

Consistency: There is a consistency of accounting treatment of like items within each accounting period and from one period to the next.

Accrual: Contributions and benefit costs are accrued, i.e. recognised for accounting purposes, as they are earned or incurred (regardless of when received or paid). Contributions and investment income for a particular year are not expected to 'match' the outgo of benefits, and the excess of income over expenditure (or expenditure over income for a 'mature' scheme) is not significant in itself.

Prudence: The pension fund accountant will only include liabilities within the accounts for events that have already occurred and which give rise to immediate transactions. If there is a potentially significant liability but it is not certain – i.e. a contingent liability, it will be noted in the accounts, but not quantified. All the probabilistic aspects can safely be left to the actuary, including all unascertained liabilities.

b) Regulations under the Pensions Act 1995 require a scheme's annual accounts to be audited. The trustees produce the accounts and the auditor then expresses an independent opinion on those accounts.

The standard audit opinions, which are contained in the auditor's reports to the scheme trustees, confirm whether for the period under review:

True and fair: the accounts give a true and fair view of the financial transactions in the period

Assets and liabilities: the accounts give a true and fair view of the disposition of the scheme's assets and liabilities.

Compliant: the accounts contain the information specified in the regulations

Contributions: as a separate opinion, that contributions have, in all material respects, been paid at least in accordance with the scheme's rules and the actuary's recommendations, or in accordance with the schedule of contributions or payment schedule in force during the period in question.

Where the auditor believes that an opinion can be given except for a particular matter, the auditor issues a **qualified audit opinion** that identifies a restriction or limitation to the auditor's opinion. An example of when this can occasionally occur is in relation to contributions, when there have been some specific issues regarding their calculation or timing. In such instances, the auditor will discuss the issues in detail with the administrator and the trustees, to ensure that there is an adequate corrective plan to prevent future occurrences. A repeat of the same issues in subsequent years would then be taken most seriously.

Auditors have a duty to inform the Pensions Regulator immediately there is reasonable cause to believe there has been a breach of duty that is likely to be of material significance to the regulator, i.e. to **whistleblow**. This is ideally done as a joint report from the actuary, auditors and trustees.

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An audit may extend to a review of administration procedures to ensure that benefits are being calculated in accordance with the scheme's rules. For this reason adequate supporting documentation must be kept in relation to each financial transaction, i.e. an 'audit trail'. In general terms, an audit trail is the ability to trace the history of a financial transaction from its initiation to its payment so that it can be reviewed and checked for accuracy at a later date. For a benefit calculation this would include the details on which the calculation is based, for instance the pensionable service and final pensionable salary used, etc. For other payments or receipts there may be an invoice, receipt or other form of authorisation.

(The relevant sections of the Study Manual are Part 3, Chapter 2.3.1 & 2.3.3)

6. **List the required components of a trustees' annual report. What is the deadline for producing the trustees' annual report and what are the disclosure requirements?**

10 marks

The annual report of a pension scheme falls naturally into a number of separate parts. The disclosure regulations require the accounts to be accompanied by an actuarial statement (for defined benefit schemes) and a trustees' report, so the annual report will contain the following:

Trustees' report: giving a review of the management of the scheme and developments during the accounting period, along with a statement of trustees' responsibilities. The report should include a list of trustees and their advisers, together with a contact name and address for enquiries. The scheme's registration number with the Pensions Regulator should be displayed prominently.

Investment report: reviewing the investment policy and performance of the scheme. This report should include reference to the Statement of Investment Principles together with details of custodial arrangements.

Compliance statement,: containing additional information which is either required to be disclosed by law (or is disclosed voluntarily but is not significant enough to go in the main report)

Auditor's report: containing the auditor's commentary on the audit and the audit opinions

Financial statements: the **fund account** shows details of cash flows, including contributions and investment income received, benefits paid, etc. The **net asset statemen**t shows the fair value of assets at the start and end of the year, net of any current liabilities.

Actuarial statements: For a scheme containing defined benefits only, providing information about the last actuarial valuation, including the agreed levels of contribution.

Statements of Recommended Practice (SORPs) set out recommended rather than mandatory practice. However, under the Pensions Act 1995 schemes must disclose whether they have complied with the SORP and explain and justify any material departure from the SORP.

The trustees' report and accounts must be signed within seven months of the end of the scheme year to which they relate. Failure to meet this deadline may result in sanctions and fines by the Regulator, if this is indicative of a breach of duty by the trustees which could adversely affect members' benefits or be of material significance.

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Members and prospective members must be told that a copy of the trustees' report and accounts is available on request, as part of the basic information about the scheme. There is no requirement for the automatic provision of copies of the Annual Report and Accounts, provided that all those entitled to receive a copy are advised of their right to receive one. A copy of the latest report must be made available free of charge within two months of the request unless one has already been issued to the individual or trade union concerned. Copies of the annual report for each of the five previous scheme years must be available for inspection on request at an accessible location and within two months of the request.

Many schemes issue to members automatically a simplified version of the trustees' annual report and accounts.

(The relevant section of the Study Manual is Part 3, Chapter 2.4)