

Taxation, Retail Investment and Pensions

Assignment 1 Notes

(Part 1 – The UK Pension System Chapters 1-6)

Recommended Time: 3 Hours

1. Explain the EET Principle.

5 marks

Answer should cover the following:

- Contributions **Exempt** from tax
- Investments built up largely **Exempt** from tax
- Pensions payable subject to **Tax**

Relevant section of the manual is Part 1 Chapter 1.1.1.

5 marks

2. Identify the changes to State Pension Ages outlined in recent Pensions Acts.

5 marks

Answer should cover the following:

- Pensions Act 2007, State Pension Age to gradually rise to 68 by 2046
- Timetable modified by Pensions Acts of 2011 and 2014.

Currently as follows for men and women

- From 65 to 66 between 2018 and 2020 (Pensions Act 2011)
- From 66 to 67 between 2026 and 2028 (Pensions Act 2014)
- From 67 to 68 between 2044 and 2046 (Pensions Act 2007)

Periodic reviews at least once every five years (Pensions Act 2014).

Relevant section of the manual is Part 1 Chapter 2.2.3.

5 marks

3. Outline the different methods that can be used to communicate with members

5 marks

Answer should cover:

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

If a scheme wishes to use electronic communications; members must be notified in advance and must be able to choose to continue to receive information by post if that is what they prefer.

Relevant section of the manual is Part 1 Chapter 2.4.3

5 marks

4. Outline the main features of a Cash Balance Scheme, explaining the similarities to a Money Purchase Scheme.

15 marks

Answer should cover the following:

Although cash balance schemes are Defined Benefit schemes, they share some characteristics of Money Purchase schemes. Like Money Purchase schemes, contributions are paid each year by the employee and employer, are invested, and at retirement the member is provided with a cash sum, which is then used to provide a pension.

The cash sum at retirement is defined at the outset and the employer will pay in whatever level of contributions is necessary to provide this lump sum.

For example, a company might set up a cash balance scheme where members pay 5% of salary each year and in return get a lump sum at age 65 of 20% of final salary for each year of membership. So a member with 10 years' service when he reaches age 65 will have a pot equal to twice his final salary, and will use this to buy a pension (although in common with other schemes, part of the benefit can usually be taken in the form of a lump sum).

Alternatively, the rules might set out what the employer's minimum contribution rate is and also stipulate a rate of investment return to be allocated, for example 7% pa. This alternative cash balance structure is also Defined Benefit, because it is possible to work out in advance what benefit (expressed in cash terms) the member will get for a given number of years' service and for a given salary.

In either case, the sum of money available to provide benefits for the member at retirement is calculated in accordance with a formula.

However, although the cash value of the benefit at retirement is defined, the amount of pension that the member will receive is not known in advance and will depend on market conditions prevailing when the member retires. In this aspect, a cash balance scheme is more like a Money Purchase scheme than a Defined Benefit scheme such as a final salary or CARE scheme.

Relevant section of the manual is Part 1 Chapter 5.1.5.

15 marks

5. Describe a cross border scheme and the requirements for an occupational scheme with its main administration in the UK.

10 marks

Answer should cover the following:

- A scheme designed to allow cross border activity and a description of cross border activity.
- Registration by a relevant supervisory body
- Technical provisions calculated on the basis of actuarial methods recognised by the Member State
- Effectively run by persons of good repute
- Governed by properly constituted rules
- Commitment to meet costs regularly by sponsoring employer where employer guarantees payment of benefits under it
- Scheme members sufficiently informed
- European Pensions Directive – requirement technical provisions to be fully funded

Relevant section of the manual is Part 1 Chapter 5.3.3.

10 marks

6. Briefly outline who may establish a personal pension.

5 marks

Answer should cover:

- Only an “authorised pension provider”
- Before 6 April 2001 provider authorised to carry on investment business. Usually:
 - Insurance companies; building societies; banks; unit trusts; friendly societies.
- Since April 2001, no such restrictions provided set up under trust.

Relevant section of the manual is Part 1 Chapter 4.2.4.

5 marks

7. Outline the main features of a centralised Master Trust.

15 marks

Answer should cover:

- Collection, reconciliation and central functions
- Administration of accounts
- Investment and fund management
- Accessing pensions savings
- Suitable governance arrangements

Relevant section of the manual is Part 1 Chapter 3.3.

15 marks

8. Draft some text for inclusion in an article on automatic enrolment for an HR publication which explains the transitional arrangements (both staging and phasing).

20 marks

Answer should cover:

Staging

- Process
- Staging Date
- Time frame for companies based on PAYE size
- 1 October 2012 to February 2018
- Flexibility to bring forward staging date

Defined Contribution (DC) Phasing

- Where DC arrangements used minimum contribution requirement will be phased in.
- Staging Date to 5 April 2018 (initially proposed to be 2016) minimum total contribution will be 2% of band gross earnings (with 1% minimum coming from the employer)
- For year 6 April 2018, the minimum rate will be 5% (2% from employer) thereafter full rate of 8% (3% from the employer) applies.

Defined Benefit (DB) Phasing

- Where DB arrangements used there will be a phasing in period from the company's staging date to end on 30 September 2017 (originally 2016).
- During the phasing in period there will be no requirement to automatically enroll existing jobholders who have been offered membership of the scheme but declined to join. Any other existing jobholders will however need to be automatically enrolled.
- All newly hired eligible jobholders must be automatically enrolled with effect from their joining dates.

Relevant section of the manual is Part 1 Chapter 3.2.3

20 marks

9. Prepare a note for the HR director outlining the principal state benefits payable in old age to those who reached state pension age before 6 April 2016 explaining the circumstances in which they were payable and what changes were implemented from that date.

20 marks

Answer should cover:

The principal state benefits payable in old age to those who reached state pension age before 6 April 2016 were the basic state pension and the state second pension.

Basic State Pension (BSP)

- Flat rate
- April 2011 increases in line with triple lock
- Triple lock explanation
- Triple lock not written into legislation

State Second Pension (S2P)

- Pensions Act 2007 provided S2P to reduce in two stages
- Flat rate top up to BSP by 2030
- Replaced by New State Pension

The single-tier New State Pension will apply to those who reach state pension age on or after 6 April 2016.

- £164.35 2018/19
- Legislation provides will be increased in line with earnings
- Current intention triple lock as currently applying to BSP
- Full rate will require 35 or more “qualifying years”
 - proportional for those with between 10 and 35 years
 - option to increase amount by paying voluntary national insurance contributions
- Transitional arrangements for those who have built up an entitlement to the basic State Pension and/or S2P at that date – foundation amount.
- Amount above level of single person guarantee credit
- Option to defer or suspend payment

With effect from 6 April 2016, there are three categories of State pensioner.

- Those who reached SPA prior to 6 April 2016.
- Those working before 6 April 2016 who will be subject to the transitional arrangements
- Those who start working on or after 6 April 2016 whose benefits will be calculated by reference to the single-tier pension only.

Relevant sections of the manual are Part 1 Chapter 1. 2, 2.2.1, 2.2.2 and 2.2.4.

20 marks