Pensions Management Institute
ACHIEVING PENSIONS EXCELLENCE

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Defined Benefit Arrangements

Assignment 2 Notes

(Part 2 – Day to Day Administration)
Recommended Time: 3 hours

1. **You are a senior administration manager training a junior colleague on the day to day aspects of scheme administration. You have to train them on AVC administration explaining the main types of AVCs, why members pay AVCs and the objectives of AVC administration. Draft some notes you can refer to cover these aspects and give to your colleague for future reference.**

20 marks

Notes should include:

Types of AVC

- DC AVCs are usually expressed as a cash fund in which contributions are invested until retirement. DC AVCs may be invested in an insurance company with profits policy or other type of policy. Such policies may provide a guaranteed annuity rate (GAR) if the annuity is purchased with the provider of the policy. The level of income depends on the investments chosen and, if an annuity is purchased, on the annuity rate (including GAR if applicable) at which the fund is converted to pension

- DB AVCs usually provide added years e.g. member contributing an extra N% of pensionable pay over the expected remaining period of membership receives one added year of pensionable service

Reasons for AVCs

- Members may be planning to retire early and so want to build up extra benefits to supplement their main scheme benefits (likely to be reduced for early payment)
- Members may have significant earnings that do not qualify for benefits under the main scheme (e.g. bonuses and overtime payments)

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Objectives of DC AVC administration

- Ensure contributions are deducted from members' pay in line with the member's instructions
- Ensure the correct levels of contributions are paid to the pension scheme within the statutory timescales
- Ensure the contribution split between members and between AVC providers (where there is more than one AVC provider) is agreed
- Ensure that the contributions are invested with the AVC provider(s) in accordance with members' investment choices in a timely manner
- Ensure that any changes to contributions (e.g. to the level of contribution, a change of provider or an investment switch) are dealt with in a timely manner in line with the member's instructions
- Ensure that any disinvestments are actioned promptly
- Where permitted by the scheme, members can use their AVCs towards the pension advice allowance
- Ensure that the AVCs are included when the member's main scheme benefits are settled (the member can take the AVCs at a different time to their main scheme benefits if permitted under the scheme rules)

Objectives of DB AVC administration

- Ensure contributions are deducted from members' pay in line with the member's instructions
- Ensure the correct levels of contributions are paid to the pension scheme within the statutory timescales
- Ensure the contribution split between members is agreed
- Ensure that the member's benefits include allowance for the benefits secured by the DB AVCs (e.g. added years) when their benefits are settled

(The relevant sections of the Study Manual are Part 2, Chapter 2.1.3, Chapter 2.2.1 and Chapter 2.2.2.)

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2. **The trustees are considering the case of a member who is suffering ill health. They have asked for your help in establishing whether, under HMRC rules, the member would qualify for early retirement on grounds of ill health. They will also need to consider whether this might be a 'serious ill health' case.**

   Draft a brief paper to explain the conditions that would apply in both scenarios, to help the trustees consider this case and reach a decision.

   20 marks

Format must include a heading, structure – introduction, main points, conclusion or summary at the end.

Points to include:

- Acknowledge that in addition to scheme rules and definitions, HMRC rules must be followed and, if the member has a GMP, a test is needed to check the level of pension at GMP payment age will be at least equal to the GMP. GMP requirements do not apply if GMPs have been converted to ordinary scheme benefits

- LTA conditions which apply to normal retirement or voluntary early retirement also apply to ill health retirement

- Additional requirements for ill health: Scheme Administrator must take qualified medical advice to be satisfied that the ill health condition defined by HMRC is met, ie the member is and will continue to be incapable of continuing their current occupation as a result of injury, sickness, disease or disability and check that the member has ceased to carry on their occupation

- Once in payment, pension can be reduced or suspended upon partial recovery or return to full health

- Serious ill health: Scheme Administrator must have evidence from a registered medical practitioner that the member's life expectancy is less than one year. HMRC allows a member in 'serious ill health' to commute any uncrystallised rights they have at any age provided the payment extinguishes all of the member's uncrystallised rights under the arrangement. If paid before age 75, the lump sum is tax-free provided the payment does not mean the member exceeds their available LTA (in which case the excess will be subject to an LTA charge); if the member has already used up all of their LTA a serious ill health lump sum cannot be paid. If paid after age 75 a serious ill health lump sum is automatically taxed under Pay As You Earn (PAYE) based on the member's marginal rate of tax and is not a benefit crystallisation event (BCE). As the lump sum must extinguish all of the member's uncrystallised rights under the pension arrangement, any survivors' benefits must be moved to a separate arrangement

- Stress how important it is to follow the rules to avoid a decision being challenged

(The relevant sections of the Study Manual are Part 2, Chapter 3.1.5 & Chapter 3.1.6.)

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3. **You are a consultant helping an employer who administers their scheme 'in-house'. They are updating their procedures manual and have asked you to provide input on the section on 'HMRC requirements on paying Lump Sum Death Benefits'.**

   Draft the main points that they should include in the manual, with a brief explanation of each.

   15 marks

The HMRC requirements that must be met when paying lump sum death benefits include:

- If the member dies before age 75 and either a defined benefits lump sum death benefit or an uncrystallised funds lump sum death benefit is paid within two years of

  - the day on which the Scheme Administrator first knew of the member's death, and
  - the day on which the Scheme Administrator could have first reasonably known about the member's death

  the payment of the lump sum is known as a 'Relevant lump sum death benefit', is a BCE, must be tested against the member's available LTA and it must be paid gross from the scheme

- The legal personal representatives (LPRs) must be notified of the date the lump sum was paid, the amount and the percentage of the standard LTA represented by the payment. This must be done within 3 months of the day on which the final lump sum is paid

- If the deceased member had exceeded their available LTA, the LPRs must notify HMRC who will calculate the LTA charge due on the excess benefits. The LTA charge due on the excess is payable by the recipient/s

- If a defined benefits or uncrystallised funds lump sum death benefit is paid on the death of a member

  - before age 75 but after the two year period (mentioned above) has ended; or
  - on or after age 75

  its payment will not be a BCE and it will be taxable at the marginal rate of the recipient. This tax charge will be deducted by the scheme

- If a member opts for any lump sum death benefit payable after retirement to be treated as a pension protection lump sum death benefit, this type of benefit is paid tax-free where the member dies before age 75 and is not a BCE so it is not tested against the member's available LTA. Where the member dies on or after age 75, tax is payable at the marginal rate of the recipient

(The relevant section of the Study Manual is Part 2, Chapter 3.2.5.)

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4. **A member is leaving pensionable service with 1 year 9 months' qualifying service in a formerly contracted out scheme. Explain the benefit options available to them.**

5 marks

Answers should include:

- If the scheme offers a deferred pension, the member could choose between a deferred benefit or a cash equivalent transfer value
- If it does not, the choice is between
  - a refund of contributions paid after deduction of a certified amount (if required by the scheme). The net refund is subject to tax at 20% on the first £20,000 repaid (including additional voluntary contributions – AVCs) and 50% on amounts above that level. The tax is usually deducted from the refund, and
  - a cash transfer sum that can be transferred to a suitable pension arrangement, eg new employer's scheme, stakeholder or personal pension arrangement

(The relevant section of the Study Manual is Part 2, Chapter 4.1.1.)

5. **A member has just left pensionable service in a scheme which was contracted out until 5 April 2016, with entitlement to a deferred benefit. Describe the treatment of benefit in excess of the guaranteed minimum pension (GMP) in the period between the date they left and their normal pension age (NPA).**

10 marks

Acknowledge that for contracted out service from 6 April 1997 to 5 April 2016, the reference scheme test basis applies.

For final salary schemes all deferred benefit that has been accrued in excess of the GMP (this includes the whole of any benefit accrued after 5 April 1997) must be increased for each complete year between leaving and NPA by:

- the lower of the increase in the CPI and 5% a year compound for benefits accrued prior to 6 April 2009; and
- the lower of the increase in the CPI and 2.5% a year compound for benefits accrued after 5 April 2009

Acknowledge that the above are minimum revaluation requirements and some schemes may provide higher revaluation levels, in particular some schemes will still apply the 5% cap to benefits accrued after 5 April 2009 or continue to use RPI as the measure for price inflation.

For career average revalued earnings schemes, either:

- the deferred benefits are revalued in the same way as final salary schemes or
- the salaries for deferred members are revalued in the same way as for members in active service

(The relevant section of the Study Manual is Part 2, Chapter 4.1.1.)

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6. **Outline the HMRC rules that apply in the event of a member transferring their benefits from one UK scheme to another UK scheme.**

10 marks

Answer should include:

- If the member had enhanced protection, fixed protection 2012, fixed protection 2014 or fixed protection 2016 they will lose this protection unless the transfer is a permitted transfer. Also, if the member has rights to a lump sum of more than 25% of the value of their pre 6 April 2006 benefits or has a protected pension age, a transfer will mean they lose these rights unless the transfer is part of a block transfer

- To ensure the transfer payment is authorised, it must be a recognised transfer. This means it must take place between registered pension schemes. A recognised transfer is not a benefit crystallisation event (BCE)

- If the transferring scheme has reason to believe that the member has previously flexibly accessed their pension rights, the transferring scheme must advise the receiving scheme of this within 31 days of completing the transfer, together with the date the member first flexibly accessed their pension rights

- A transfer that is not a recognised transfer is an unauthorised payment and tax charges will apply against the member and the trustees of the transferring scheme

(The relevant section of the Study Manual is Part 2, Chapter 4.2.4.)

7. **You are an administrator for the pension scheme and a new contact at the employer has asked you to prepare a summary paper explaining how the statutory rights to cash equivalent transfer values currently operate. They have also asked you to include details of the appropriate independent advice requirement. Draft the main points you should include in your paper.**

20 marks

Answer should include:

- Members have the statutory right to transfer out each category of their benefits. Three categories are recognised:

  - Money purchase benefits (also known as flexible benefits)
  - Flexible benefits that are not money purchase benefits (e.g. cash balance benefits)
  - Benefits not covered by the above two definitions (e.g. salary related or CARE benefits – so typically defined benefits – also known as safeguarded benefits)

- Defined benefits members have the statutory right to transfer the cash equivalent of those benefits to another suitable arrangement if:

  - They have stopped accruing the benefits at least one year before normal pension age (NPA)
  - None of the benefits has been used to provide a scheme pension
  - The member's application to transfer is received at least one year before NPA

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- DC AVCs (money purchase benefits) members have the statutory right to transfer these benefits to another suitable arrangement at any point until the member:

  - uses any of their money purchase benefits to provide a scheme pension or lifetime annuity, or
  - designates any of their money purchase benefits as available for the payment of a drawdown pension

- Appropriate independent advice requirement:

  - Members must obtain appropriate independent advice before transferring safeguarded benefits to an arrangement providing flexible benefits
  - Advice requirement applies where the value of the member's safeguarded benefits exceeds £30,000 (regardless of the amount transferred)
  - If the full transfer value of the safeguarded benefits exceeds £30,000, the transferring scheme must tell member that they will need to take appropriate independent advice before transferring to an arrangement providing flexible benefits
  - Prior to transfer proceeding, transferring scheme must receive written evidence from the member's adviser confirming they have given the member advice relating to the transfer and that they are authorised to give such advice
  - Transferring scheme must check that the adviser has permission to provide advice by checking the Financial Services Register maintained by the Financial Conduct Authority

(The relevant sections of the Study Manual are Part 2, Chapter 4.2, Chapter 4.2.1 and Chapter 4.2.3.)