Pensions Management Institute
ACHIEVING PENSIONS EXCELLENCE

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# Defined Contribution Arrangements

## Assignment 3 Notes

*(Section 3 – Benefits from Workplace Defined Contribution Schemes and Section 4 - Defined Contribution Scheme Governance and Investments)*

*Recommended Time: 3 hours*

1. **You are the Scheme Administrator for the ABC Defined Contribution Scheme and you have been notified that a member aged 64 on a high salary and with a large accumulated pension fund has died in service. Prepare a short note to a newly appointed member-nominated trustee advising her of the potential options for dealing with death benefits in this case and summarising the tax treatment of such options.**

**10 marks**

Format: In the style of a formal note.

Style: Formal but as clear and concise terms as possible.

Answer should include:

- The MNT should have regard to the content of the scheme rules.
- Benefits may include an insured death-in-service lump sum as well as the uncrystallised rights in the pension fund.
- The two-year time limit for making a tax-free payment and the date from which it is triggered.
- This is a Benefit Crystallisation Event and the Lifetime Allowance Test will apply so long as distribution is done within the two-year time limit.
- The tax treatment of the lump sum if the Lifetime Allowance is exceeded.
- The tax treatment of the lump sum if the two-year time limit is missed and that the administrator is responsible for deducting before payment.
- The option to provide, and the tax treatment, of survivor's annuities and drawdown pensions.

Students should not provide information on the death post age 75 scenario.

(The relevant sections of the Study Manual are Part 3, Chapter 1.3.1)

2. **A member with a right to a statutory transfer has been provided with a cash equivalent transfer value and responds by applying for an overseas transfer. Outline the matters that need to be taken into account by a Scheme Administrator in responding to and processing such a request.**

**12 marks**

Answer should cover the listed items below:

- Check member has provided the essential relevant information about the receiving scheme
- Timescale for payment of a transfer value where requirements are met is within six months
- Check that the receiving scheme is described as a QROPS and details are sufficient for a check of HMRC's published ROPS list
- Ask for Lifetime Allowance details from the member as such a transfer will be a Benefit Crystallisation event
- 
- Potential Lifetime Allowance charge of 25% may have to be deducted by the Scheme Administrator if Lifetime Allowance already exceeded or no information provided
- Check required to establish if the Overseas Transfer Charge applies – it does unless all the required information is provided by the member before the transfer shows that there is an exemption

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- The exemptions to the Overseas Transfer Charge are where member is resident in the same country as the QROPS (or if it is within the EEA and the member resides in EEA) or QROPS is an occupational pension scheme of the member's employer, or an overseas public service scheme or a scheme established by an international organisation.
- Alert member to the risk of a pension scam
- Check scheme's ROPS status before making any transfer payment

Answer should not cover statutory transfer right or quotation rights as the question states that these have already been met

(The relevant sections of the Study Manual are Part 3, Chapter 1.4.2, 1.4.3 and 1.4.4)

**3. You are a Pensions Consultant for the XYZ Defined Contribution Scheme and the Trustees are considering offering members the option of taking their retirement benefits either as an Uncrystallised Funds Pension Lump Sum (UFPLS) or via the combination of a Pension Commencement Lump Sum (PCLS) and a Flexi-Access Drawdown (FAD) fund. Prepare a paper for the Trustees outlining the key features of the two options.**

**20 marks**

Format: Report, title/heading, contents, summary, main text, conclusions

Style: Formal

Answer should cover:

- PCLS and FAD
    - PCLS is up to 25% of the combined amount of funds being designated to FAD (subject to having available Lifetime Allowance).
    - PCLS is tax-free and can be paid up to 6 months prior to and 12 months after designation of rest of the fund as a FAD fund.
    - Option to take PCLS and defer taking any income from the FAD fund.
    - Allows flexible access of benefits.
    - No min/max amount of income from drawdown fund (but withdrawals limited to maximum of amount actually designated to FAD).
    - A FAD withdrawal will trigger the MPAA (but MPAA is not triggered if PCLS taken and income deferred).
    - Scheme can impose restrictions on how FAD can operate.
    - Option to purchase short-term annuity.
    - Designating to FAD, purchasing a short-term annuity and paying a PCLS are BCEs.

- UFPLS
    - Draw uncrystallised savings as a one-off lump sum or series of lump sums
    - 25% payable tax free (but this is different from a PCLS), remaining 75% taxable at individual's marginal rate of income tax.
    - Scheme can impose restrictions, e.g. how many UFPLSs they will allow or minimum amount.
    - Payment of an UFPLS is a BCE.
    - UFPLS can only be paid when an individual has available LTA.
    - First UFPLS payment triggers MPAA.

(The relevant sections of the Study Manual are Part 3, Chapter 1.5.3, 1.6.1, 1.6.2 and 1.6.3)

**4. Explain the conditions that apply to the new options introduced in 2018 for bulk transfers without consent**

**8 marks**

Answer should cover:

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- Options apply only to pure DC rights; that is excluding DB, cash balance and other rights with any form of guarantee
- Option 1 – Bulk transfer to an authorised master trust, but in practice only available once the Pensions Regulator has approved the relevant master trust
- Option 2 – Bulk transfer between 'connected schemes' – where the controlling employers of each scheme are part of the same connected group
- Option 2 members must be current or former employees of a group employer
- Option 3 – Bulk transfer based upon the written advice of an independent professional that has been obtained and considered by the trustees.
- Government guidance should be considered by trustees when looking at option 3.
- Key message is that trustees should ensure decision is consistent with fiduciary duties and in the best interests of members.
- Charge cap on DC rights will continue to apply if transfer is from an arrangement already subject to the cap.

Answer should not cover old bulk transfer option and its withdrawal.

(The relevant section of the Study Manual is Part 3, Chapter 1.10.4)

**5. The PQR Defined Contribution Scheme is a new scheme about to be set up. Its intended trustees have asked you, the Pensions Consultant, about the requirement to appoint a Chair of Trustees and issue an annual Chair's statement. Prepare a briefing paper for the future Trustees which outlines the appointment of a Chair, the responsibility for producing the Chair's annual statement and the information that must be included in it.**
**20 marks**

Format: Introductory paragraph, detailed information of each subject area, summary.

Style: Formal, but assuming only basic knowledge of the subject.

Answer should cover:

- Requirement to appoint Chair of Trustees within three months of the scheme's establishment.
- Chair's details included on Scheme Return, which must be updated as soon as reasonably practicable.
- Requirement to produce a Chair's Statement within seven months of the end of each scheme year. Chair is responsible for signing the Chair's statement.
- However, all trustees continue to have joint and several responsibilities in the running of their scheme. If a chair has ceased to hold office but no replacement appointed then the statement may be signed by a person appointed to act as the chair in the interim period.
- Failing to produce the statement will result in a mandatory fine that the trustees are jointly and severally liable for and which can be between £500 and £2,000.

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- Statement should cover specific areas around minimum governance standards:
  - Default fund – SIP must be included with details of reviews.
  - Core financial transactions – must describe how requirement for prompt and accurate processing has been met.
  - Charges and transaction costs – must provide, on a standard basis, details of these costs and indicate what has not been obtainable
  - Good value for members – state to what extent the transaction costs and charges represent good value for members
  - Illustrative example of cumulative effect of charges over time – information to be presented in the form of a table
  - Trustee knowledge and understanding – the extent to which trustees have met the requirements along with confirmation of the professional support they receive.

(The relevant section of the Study Manual is Part 4, Chapter 1.3.6)

**6. Outline the key features of balanced funds, multi-manager funds and the slippage cost method.**

**10 marks**

Answer should cover:

- Balanced funds
  - Are likely to be a mixture of growth and lower risk investments, hence the term 'balanced' – i.e. a mixture of UK and overseas equities and other assets including bonds, cash and property.
  - Are affected by the rise and fall in equity values, but because they also contain other assets, they are likely to be less volatile than pure equity funds but also expected to have moderated returns - better over the long term than bond and cash, but lower than pure equity funds.
  - Are normally suitable for members with more than five years until they retire – depending on the mix of growth assets (equities) and less risky assets (gilts and corporate bonds) each fund will have different characteristics, although typically they have a high proportion of equities.

- Multi-manager funds
  - Concept is that funds that use best managers in each asset class in order to get best possible investment return.
  - Manager of managers – one manager of managers is appointed to select a few specialist managers, monitor their performance and alter the composition of the team to adapt to market conditions or fund performance. Each of the selected specialist managers has a specific investment mandate for their specialist fund.
  - Fund of funds – A manager builds up a portfolio that invests in funds run by a number of other managers.

- Slippage cost method
  - It is the difference between the price of the transaction when executed and the price when it was first placed with a third party.
  - This is the actual cost / true test of the loss of value to the scheme and members.
  - Used in investment industry for over 20 years / in line with PRIIPs Regulation.
  - Downside is that market movements and other costs included which do not represent direct fees or charges (e.g. transaction taxes are a cost but not within the control of the investment manager).

(The relevant sections of the Study Manual are Part 4, Chapter 2.2.5, Chapter 2.2.6 and Chapter 3.4.2)

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**7. Describe the key elements in designing a default fund for a qualifying DC scheme, including which funds qualify as default funds and the restrictions that apply to member-borne deductions.**

**20 marks**

Answer should cover:

- A default fund is for members who have not made an active investment choice.
- Design should involve a high-level objective and be suitable for the employees, given their characteristics and needs.
- Fund should be appropriately and competitively priced with the effect of charges made clear.
- Fund should have an investment strategy that manages risk through an appropriate and diversified allocation of assets with the overall objective in mind.
- Under employer duties:
    - funds which have 80% or more of the existing scheme membership are also default funds if a choice was required for scheme membership.
    - Funds which have 80% or more of the new joiners after April 2015 (or later employer staging date) joining them where a choice was required for scheme membership are also default funds.
- Once a fund qualifies as a default fund, its status is fixed.
- Charge cap of 0.75% annually applies to member-borne deductions from default funds.
- Deductions covered include both general scheme administration and investment administration charges but with certain exemptions such as transaction costs, death benefit charges, member opt-in service charges, pension sharing charges, court order costs and winding-up costs.
- Charge cap basis can involve one three permitted charge structures: AMC, Contribution Charge and AMC, and Flat Fee and AMC – with an appropriate summary of the different limits.

(The relevant sections of the Study Manual are Part 4, Chapter 3.2.1, 3.2.2, 3.2.4, 3.3.1 and 3.3.2)