INSTITUTE AND FACULTY OF ACTUARIES

Scenario Material

14 April 2021 (am)

Subject CP3 – Communications Practice

INSTRUCTION FOR CANDIDATES

You are provided with this advance information to enable you to read and understand it in your own time and not under examination conditions. Please note that this is an examination to test your ability to communicate technical information to a non-technical audience. It is not a test of your technical actuarial knowledge or skills. As such, any technical actuarial information or techniques needed to answer the question will be provided to you. You do not need to spend time revising other subjects or researching further detail on the topics covered in the paper.

 © Institute and Faculty of Actuaries

Background

OTA Master Trust (OTA) is a defined contribution occupational pension scheme that can be used by multiple employers in order to provide pension benefits for their employees.

How the scheme works

Under the scheme, each individual employee will have their own pension savings account (or ‘pension pot’). Contributions are made to the pension pot by the employee and the employer, plus tax relief from the government, on contributions paid. The employees are considered to be ‘members’ of the pension scheme.

The scheme is fully investment-linked, the contributions are invested in assets and members may be able to choose the type of assets invested. The benefit at retirement or death will be the value of the members’ pension pot and is therefore totally dependent on the accumulated value of these contributions.

Charges are deducted from the pension pot monthly to cover both the cost of administering the pension scheme and the investment costs.

Members are either:

- active: a member who is at present accumulating a pension pot under that scheme in respect of current service; or
- deferred: a member no longer accumulating a pension pot but who has a pension pot that will be available at a future date. A member will be deferred if they leave their employer.

At retirement, members can choose how they wish to use their pension pot. Most members choose to take a tax-free lump sum of up to 25% of the value of their pot and then convert the remaining value in their pension pot into an annuity. The annuity amount for a given size of pension pot is determined by the annuity basis chosen and the provider’s annuity rate at the point of annuitisation. The annuity basis options will generally include:

- single or joint life
- escalating or not escalating
- frequency of payments
- payment in advance or arrears.

The annuity purchase rate will depend on the following factors:

- gilt yields
- expectations regarding longevity
- level of competition in the annuity market
- insurers’ capital requirements for annuity policies.

You have been provided with:

- promotional material aimed at prospective employers explaining the OTA
- OTA member numbers for the last 5 years
- data on the size of pension pots at OTA
- pension charges review for OTA, which was undertaken in 2018.

Promotional material for prospective employers

Auto-enrolment and what it means for you as an employer:

Auto-enrolment was introduced in 2012, and now, by law, every employee must be automatically enrolled into a pension scheme. As an employer, it is your responsibility to offer a workplace pension scheme to your employees and enrol them in it. As well as the regulations about enrolment, there are a number of other responsibilities associated with running a workplace pension scheme.

We know that this all sounds daunting, especially if you are a new, or a small, business – you want to concentrate on your business, not on pension regulations. That is where OTA can help. We are an occupational, trust-based pension scheme open to all businesses. We already provide pension schemes for a variety of employers, and we could help you too.

Frequently asked questions:

Why was auto-enrolment introduced?

Auto-enrolment was introduced to encourage more individuals to save for later in life. While historically those in higher-paid jobs were already saving into a workplace pension scheme, this was not the case across the wider spectrum. It is intended that by automatically enrolling all employees into a pension scheme, irrespective of salary, later life planning is encouraged at an earlier stage.

The introduction of auto-enrolment in 2012 has made an impact on the number of people saving for their retirement. Over 87% of eligible employees are now participating in a workplace pension scheme, compared to 55% of eligible employees before auto-enrolment was enforced. In particular, the participation rate for 22- to 29-year olds has more than tripled since 2012.

What is a master trust?

A master trust is a defined contribution pension scheme set up under trust. The master trust provides a workplace pension that can be used by multiple unrelated employers.

A pension scheme set up under trust ensures that the scheme's assets are kept separate from those of the employer. This is important for the security of members' benefits.

The master trust is governed by a board of trustees. Their role is to make decisions that are in the interests of the scheme members. This will include reviewing investment decisions, determining how charges should be apportioned between members and, ultimately, ensuring that the members are paid the benefits that they are legally entitled to according to the rules of the trust.

How does the scheme work?

If your company joins OTA, then each of your eligible employees will have their own individual pension pot. Employees pay contributions into their pension pot (from their salary), and you, as their employer, also make contributions for each employee. In addition, tax relief is added from the government on the contributions paid.

The pension pot is invested in assets as chosen by the employee. They can choose from a range of funds, depending on their approach to risk.

At retirement, the value of the pension pot is available for the employee.

What happens if an employee leaves the company?

If an employee leaves your company, their pension pot will remain within OTA but no further contributions will be made. They continue to be a member of the trust and charges will still be deducted from their pension pot. We refer to accounts where contributions have ceased as ‘deferred’.

If the employee moves to another employer, then they will automatically be enrolled in the pension scheme offered by the new employer. A member can request for the funds from their deferred pension pot to be transferred to their new pension scheme, but otherwise the funds will remain in the OTA.

Member numbers for OTA (as at 31 December)

Year	*Number of active pension pots*	*Number of deferred pension pots*
2020	30,714	30,536
2019	30,628	24,497
2018	29,752	21,998
2017	28,861	14,014
2016	28,104	10,396

Size of pension pots on 31 December 2020

Value (£)	*Number of pension pots*	*Number of active pension pots*	*Number of deferred pension pots*
0–249	5,346	51	5,295
250–499	6,873	359	6,514
500–749	8,401	1,759	6,642
750–999	10,692	3,375	7,317
1,000–1,249	8,219	5,179	3,040
1,250–1,499	7,637	6,113	1,524
1,500–1,749	5,041	4,876	165
1,750–1,999	1,527	1,512	15
2,000–2,999	2,902	2,889	13
3,000–3,999	1,375	1,370	5
4,000–4,999	611	607	4
5,000–7,499	1,527	1,526	1
7,500+	1,099	1,098	1
Total	**61,250**	**30,714**	**30,536**

Pension charges review 2018

The purpose of this review is to check whether the current pension charging structure is sufficient to cover the necessary expenses. In order to do this, the master trust was modelled based on data at 31 December 2017. The modelling considered only the current charging structure. As part of the review, the charges prevalent in the industry were also investigated and considered.

Assumptions used in modelling

- Number of pots will increase by 15% each year.
- Deferred pots will account for 40% of total number of pots.
- Future fund growth will be taken as the average growth for each fund over the period 2014 to 2017.
- Future inflation will be at the rate during the year to 31 December 2017.

Background

A charge is deducted from a member's pension pot at the beginning of each month. The charge is taken to cover the cost of administering the account and the cost associated with investments. The same charge is applied to all members.

The charge taken needs to cover:

- administrative costs (approx. £20 per active pot per year, £15 per deferred pot per year).
- investment costs (this includes brokerage fees, transaction fees and performance fees).
- levy paid to regulator (in 2017 this was £1.50 per member and applies to all master trusts).

Current charge structure:

The current charge is a £16 annual flat fee and 0.25% p.a. Annual Management Charge (AMC).

Review outcome

The simulations from the model found that, for the assumptions stated, in 90% of cases, the current charging structure was adequate and would continue to cover the expenses for the next 10 years.

Popular industry charge structures

The review also looked at the charging structure of other master trusts, to ensure the charging was in line with the industry.

There are three popular charging structures currently used:

- a fixed annual fee + percentage AMC (as currently used by OTA)
- a percentage AMC only (typically around 0.5% – the maximum charge permitted by legislation is 0.75%)
- a fixed annual fee only (typically £24).

These alternatives were considered but concerns were raised about them.

Charging only a fixed annual fee will result in all members being charged the same, irrespective of pot size. It will, therefore, be unlikely to adequately cover the investment costs of larger pots.

Charging a percentage AMC will better reflect the investment expense associated with a pension pot. Even at the maximum permissible 0.75% AMC, this would not cover all the costs for small pots.

It was decided a combined charging structure ensured that the charges reflected some degree of proportionality while also ensuring that the costs could be recovered.

END OF SCENARIO MATERIAL