INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

April 2018

Subject SA4 – Pensions and other Benefits Specialist Applications

Introduction

The Examiners' Report is written by the Principal Examiner with the aim of helping candidates, both those who are sitting the examination for the first time and using past papers as a revision aid and also those who have previously failed the subject.

The Examiners are charged by Council with examining the published syllabus. The Examiners have access to the Core Reading, which is designed to interpret the syllabus, and will generally base questions around it but are not required to examine the content of Core Reading specifically or exclusively.

For numerical questions the Examiners' preferred approach to the solution is reproduced in this report; other valid approaches are given appropriate credit. For essay-style questions, particularly the open-ended questions in the later subjects, the report may contain more points than the Examiners will expect from a solution that scores full marks.

The report is written based on the legislative and regulatory context pertaining to the date that the examination was set. Candidates should take into account the possibility that circumstances may have changed if using these reports for revision.

Luke Hatter
Chair of the Board of Examiners
July 2018

A. General comments on the aims of this subject and how it is marked

1. The aim of the Pensions and other Benefits Specialist Applications subject is to instil in successful candidates the ability to apply knowledge of the United Kingdom pensions and employee benefit environment and the principles of actuarial practice to providers of pensions and employee benefits in the United Kingdom.

2. This subject examines the ability of candidates to apply actuarial practice and concepts, together with specific knowledge of the UK pensions and employee benefit environment to potentially complex problems, integrating their analysis into a coherent whole, and evaluating and interpreting results to draw explicit conclusions.

3. The Examiners therefore look for candidates to demonstrate their understanding of the syllabus but in particular they need to demonstrate ability in applying their knowledge and core actuarial skills to the specific situations that the Examiners have raised, having read the question carefully. Consistently, many of the unsuccessful candidates provide answers that are not sufficiently specific to the subject matter of the question, reproduce core reading that does not directly relate to the question context, or focus on one specific point without covering a sufficient range of points to answer the question. This does not enable the candidates to achieve the required marks. The Examiners encourage future candidates to remind themselves of what they learned in the Core Actuarial subjects, and to use past paper questions to practice applying these skills to the specific scenarios tested.

4. Good candidates demonstrate that they have structured their solutions well – this is a big advantage in making points clearly and without repetition. There is a significant incidence of points being repeated in slightly different ways, restricting the scope for candidates to score marks. Good structure enables candidates to use the latter parts of questions to generate ideas for answers to the early parts (or use their solutions to earlier parts of questions to create a structure for latter parts). Time management is important so that candidates give answers to all questions that are roughly proportionate to the number of marks available. The questions are set so that it should take approximately twice as long to answer a 10 mark question as a 5 mark one. Answers should therefore be similarly proportionate.

5. In addition, candidates should carefully consider the instruction – for example an instruction to list points should be answered with a list without attaching discussion. Similarly, a question asking for a discussion cannot be answered with a list of undeveloped points.

6. Finally, it is very helpful to the Examiners if candidates clearly identify points made; if they are set out clearly, well-spaced and easily legible. Whilst there is no loss of marks for not doing so, doing so does make it easier to identify scoring

opportunities.

7. Candidates who give well-reasoned points, not in the marking schedule, are awarded marks for doing so.

B. General comments on *student performance in this diet of the examination*

This was seen to be a challenging exam, particularly as some of the book work questions came from parts of the syllabus that are tested less frequently.

As with previous years the application aspects of the course are harder to score well on. This is an area that SA4 candidates consistently need to work harder on in preparation. By taking a methodical approach to answers, step by step, however, there are opportunities to score well. It is important that candidates make sure they provide a full answer to all questions.

Breaking the question down into smaller parts helps to make sure that a suitable breadth of answer is supplied. It is critical that candidates check that their answers specifically refer to the details of the question, using all of the information in the question pre-ambles. It is not the intention of the examiners to include information in the questions that is not relevant to the answers.

Candidates should take note of the command verbs used to guide the depth given in their answers (a list of what is expected for each verb is available on the IFoA website).

Candidates should also note the number of marks available for each question as a guide of how many points they need to cover.

C. Pass Mark

The Pass Mark for this exam was 55.

Solutions

Q1 (i)

- any transfer payment must be calculated in a manner that is consistent with the trust deed and rules of the transferring pension scheme [1]

- and in some cases the trust deed and rules will prescribe the approach to be used [½]

- however, in most cases, the transfer payment is likely to reflect a valuation of the accrued rights of the transferring member [½]

- which may include an allowance for projected earnings growth (a "past service reserve") [½]

- alternatively, a valuation of leaving service benefits may be undertaken [½]

- the basis could be in line with funding, buyout, best estimate etc. [½]

- in both cases, the assumptions used for the calculation may be subject to negotiation between the parties [1]

- although it should be noted that cash equivalent transfer values (to which members have an automatic entitlement) may form an effective underpin on the amount to be offered [½]

- noting that in very poorly funded schemes, these may be subject to reduction [½]

- in some cases, the transferring scheme trustees or the purchaser may wish to directly reflect the level of funding of the scheme to ensure that benefit security for the remaining members is maintained [½]

- in this case, the value of the assets would be split in accordance with a valuation of the transferring member benefits compared to the valuation of all benefits (a so-called "share of fund" calculation) [½]

- potentially recognising the priority order that would be applied if the scheme wound up [½]

- and which may be underpinned by a valuation of leaving service benefits (either for the scheme as a whole or on a member by member basis) (if the scheme is poorly funded) [½]

- or may result in more than the past service reserve being paid (if the scheme is in surplus on that basis) [½]

- the trustee may also have some regard to the benefits being offered in the receiving scheme for the transfer payment [½]

- so for example will seek to pay a lower amount if that is unlikely to affect the transfer credit being offered in the receiving scheme [½]

- **or** if the receiving scheme has a material surplus (with some expectation that at least part of this will be applied to the benefit of the transferring members) [½]

- the transfer payment may recognise the value of discretionary benefits [½]

- (although it should be noted that these are likely to be converted to guaranteed benefits in the receiving scheme) [½]

[Max 6]

(ii)

- the trustees will need to balance the interests of active members who are employees of both companies (A and B) and deferred and pensioner members of the scheme [1]

- noting that the covenant offered by Company X is now effectively worthless [½]

- assuming parent has no financial obligation [½]

- the trustees need to determine how any transfer payment should be calculated [½]

- including the method and assumptions [½]

- and will require up to date financial information about the scheme [½]

- e.g. funding position on SFO, solvency, PPF, best estimate bases [½]

- noting that it was 95% funded on a technical provisions basis two years ago [½]

- they may want to reflect any differences in assumptions that are relevant to the profile of transferring employees of Company A [½]

- e.g. if they are likely to experience greater longevity or have higher pay increase expectations [½]

- and need to decide whether to allow for discretionary benefits in the calculation [½]

- (noting that these would not be available were the scheme to wind-up or enter the PPF) [½]

- information will also be needed on the assumptions that the receiving scheme will adopt when converting the transfer payment in to a benefit in the receiving scheme[½]

- certification required if benefits changed without consent [½]

- and the nature of that benefit (e.g. will it be linked to final salary or will another form of defined benefit be offered) [½]
- the trustees should seek to obtain information on the financial position of the receiving scheme (e.g. is it in surplus or deficit) [½]
- and the covenant of the Company Y [½]
- the trustees may want to consider the benefits that non-transferring members will receive (likely to be slightly in excess of PPF benefits if the proposal is accepted) [½]
- and offer a transfer payment which is calculated to generate this level of benefit in the receiving scheme [½]
- however, given that the benefits for non-transferring members may to be independent of the size of the transfer payment offered if PPF benefits not covered on solvency basis [½]
- the trustees may prefer to pay a relatively high amount [½]
- even if that means that the transferring members are relatively better off compared to the non-transferring members [½]
- security of non-transferring members should also be considered [½]
- any constraints contained within the trust deed and rules should be considered [½]
- and there are a number of practical issues that need consideration including: [½]
    - how the transfer offer will be communicated to members [½]
    - the timescale of the proposed transaction [½]
    - the legal documentation that will be required [½]
    - the form of assets that will be transferred [½]
    - or whether a cash payment is anticipated [½]
    - a roll forward agreement up to date of actual payment [½]
    - consult the Pensions Regulator [½]
    - all sides will need legal advice [½]
    - any impact on investment strategy [½]

[Max 8]

(iii)

- members who have reached normal pension age (NPA) or retired as a result of ill-health will receive their pension in full from the date that the PPF takes responsibility for payment [½]
- where NPA is defined as per preservation rules [½]
- and irrespective of whether the pension is actually in payment or not [½]
- all other members receive 90% of their accrued pension from NPA [½]
- although the accrued pension is subject to a compensation cap [½]
- equal to £38,505 p.a. in 2017/18 (for an NPA of 65) (anything close is acceptable) [½]
- For members with 21+ years' service, cap is increased by 3%
- which is applied in aggregate to the pensions from all schemes with the same employer [½]
- there is a lump sum entitlement of up to 25% of the PPF pension payable at NPA [½]
- PPF pensions in relation to accrual after April 1997 are increased by the lower of CPI and 2.5% per annum [½]
- and no increase is payable in relation to pre-April 1997 accrual [½]
- deferred pensions are revalued in line with CPI up to NPA [½]
- subject to a cap of 5% per annum for accrual prior to April 2009, and 2.5% per annum for later periods [½]
- spouses pensions are payable equal to 50% of the members PPF pension [½]
- the PPF board has the power to vary the revaluation and indexation benefits if they decide that the financial position of the PPF requires this action [½]
- and in very extreme situations, the Secretary of State has the power to reduce PPF benefits further [½]
- no allowance for discretionary benefits or increases [½]

[Max 6]

(iv) **Is it equitable?**

- the remaining members of Scheme X will consist of the Company B employee members, Company A employee members who decided not to transfer, and deferred and pensioner members (some of whom will be older and others younger than NPA) of the scheme [½]

- the employer debt requirements mean that Company X has a responsibility to fund the scheme to a buyout level of funding on a scheme winding up [1]

- so the starting position is that benefits should be payable in full (not just at an enhanced PPF level) [½]

- however, we are told that Company X does not have the resources to meet any part of the employer debt that would be due to be paid [½]

- assuming overseas parent has no financial obligation [½]

- assuming that this is indeed the case, then the benefits that are payable depend on the funding position of the scheme [½]

- the scheme may be funded on a solvency basis in excess of PPF benefits, given the funding position of 95% on a technical provisions basis just two years ago [½]

- if it is funded in excess of PPF benefits then the benefits will be equal to the PPF benefits, plus additional benefits in accordance with the statutory priority order [½]

- which requires assets to be applied in the following order i) expenses, tax, loan repayments ii) certain insurance policies iii) PPF benefits iv) AVC's and v) other accrued benefits including increases [1]

- so pensioner members (aged over NPA) would not suffer an immediate reduction to their pension [½]

- although contingent spouse's pension may reduce [½]

- and other members would see a reduction to the starting amount of their benefits of up to 10% [½]

- or more for any member impacted by the compensation cap [½]

- active members lose future accrual and link to final salary [½]

- if the scheme is funded below PPF benefits, then the payment by the overseas employer will result in new monies being paid in to the scheme which will improve member outcomes in aggregate [½]

- however, if this new money is applied augment benefits for all members by 3% [½]

- so pensioners (aged over NPA) would see an immediate increase of 3% to their pension which would not arise if the overall scheme funding position were in excess of PPF benefits [½]

- and other members would be faced with a reduction of 7% of their accrued benefits (assuming they are not impacted by the compensation cap) [½]

- this is a different outcome to that which would apply if the payment from the overseas employer were made directly to the scheme with no conditions on its application [½]
- since in that situation, there would be no 3% augmentation for pensioner members above NPA [½]
- and a lower level of reduction to the benefits of other scheme members [½]
- in conclusion, the conditions of the proposal are such that pensioner members above NPA are preferred and so the offer is not equitable between the members compared to scheme benefits [1]
- but it is compared to PPF benefits [½]
- the alternative option is to use the 3% enhancement to bring benefits closer to full scheme benefits [½]
- this would be more equitable compared to scheme benefits [½]
- but not compared to PPF benefits [½]

[Max 7]

(v) **Risks**

- biggest risk is that members' benefits are lower than otherwise as: [1]
- the scheme is already funded above PPF benefits so that the overseas employer is not in fact obliged to make a discretionary payment [½]
- the overseas employer is unable to make the payment [½]
- a higher payment from the overseas employer would have been required as a result of a contribution notice [½]
- company X is actually able to settle at least part of its employer debt liability [½]
- or other group companies also have a liability under employer debt legislation which they are able to meet, at least in part [½]
- in practice, the trustees may not be able to secure the insurance contracts on the date that the overseas employer makes the payment [½]
- and so there will be an investment mismatch [½]
- which may mean that lower (or higher) benefits are in fact secured [½]
- there is an expense risk that could mean benefits are reduced [½]

- there is a risk that the insurer defaults [½]

[Max 3]
[Total 30]

Parts i and ii were reasonably well answered by the better candidates. A common problem was where some answers were not sufficiently detailed to get the marks available. Repetition of the same or similar points does not get additional marks; nor do points not directly relevant to the question being asked.

Part iii was well answered, although it was surprising that more candidates did not get full marks.

Part iv and v were not well answered generally. A lot of candidates seemed to ignore the word "equitable" in the question so just commented on what members would get, rather than whether it was fair.

This highlights the importance of the specific wording of the question and the useful information contained within it, to help candidates answer the question.

Q2 (i) Six certificates:

3 marks available for naming 6 certificates, with the other 3 marks available for descriptions – more than ½ mark may be awarded for describing any given certificate subject to a maximum of 3 marks overall

- An employer debt certificate [½]
  - Triggered by the insolvency of the sponsoring employer or a decision taken by the sponsoring employer to cease sponsorship of the scheme [½]
  - Required under section 75 of the Pensions Act 1975 [½]
  - Equal to the full buyout cost (including expenses) of the liabilities of the scheme less the market value of the assets [½]
- A section 179 certificate [½]
  - Used in the calculation of the levy payable to the Pensions Protection Fund[½]
  - Required to be produced at least every three years [½]
  - Broadly equal to the cost of buying out PPF liabilities with an insurance company (although the PPF specifies the assumptions that need to be used)[½]

- Certification of the adequacy of a schedule of contributions [½]
    - Produced as part of the triennial actuarial valuation process [½]
    - So required at least every three years [½]
    - Included on annual report and accounts [½]
    - The actuary must certify that the schedule of contributions is adequate to meet the Statutory Funding Objective [½]
    - And consistency with Statement of Funding Principles [½]
- Certificate relating to proposed change to accrued rights of members [½]
    - Triggered by any proposal from the sponsoring employer to modify the accrued rights of one or more members [½]
    - Intended to ensure that the value of the accrued benefits are not reduced as a result of the modification [½]
    - Does not cover future service benefits [½]
    - Allows trustees to amend accrued rights without members' consent [½]
- Bulk transfer certificate [½]
    - Triggered by a proposal from the sponsoring employer to transfer member benefits from one arrangement to another without seeking the consent of the members involved [½]
    - Intended to ensure that rights broadly no less favourable as a result of the transfer [½]
    - Allows for discretionary practices and benefits [½]
- Refund of surplus certificate [½]
    - Triggered by the application from the sponsoring employer for a refund of surplus assets in the scheme [½]
    - Although the trustees have the power to decide whether or not to agree to the request [½]
    - The maximum amount is the difference between the assets and the buyout cost of the liabilities [½]
- Deficit Reduction Certificate [½]

  - Submitted to PPF with contributions in excess of those required to meet cost of accrual on PPF basis [½]
  - Used to calculate risk-based levy [½]

- Section 143 Certificate [½]
  - Certifies funding level for entry into PPF [½]

- Technical Provisions Certificate [½]
  - Certifies Technical Provisions calculated in accordance with SFP [½]

[Marks should be given for the 6 certificates getting the best marks] [Max 6]

(ii) **Considerations**

An employer debt certificate

- Timing – for a solvent employer, the trustees can choose the effective date (after the employer ceases to sponsor the scheme but prior to any insolvency event) to try to maximise the debt [½]

- Assumptions – should the estimate of the buyout cost have regard to actual market quotations or be based on rules of thumb provided by the actuary's employer? [½]

- Benefits – the calculation should be based on guaranteed scheme benefits only (i.e. discretionary benefits should be ignored) [½]

A Section 179 certificate

- Timing – there is discretion around timing of the certificate which can be selected to reduce the amount of PPF levy payable [½]

- Assumptions – these are available from the PPF's website, and are regularly updated. The actuary needs to ensure that the assumptions used are up to date, and that any ambiguity is clarified with the PPF. [½]

- Benefits – the calculation must use the benefits that would be offered by the PPF [½]

- Can't underestimate liabilities (or overestimate contributions) [½]

Certification of the adequacy of a schedule of contributions

- Timing – the certificate is normally provided as at the valuation date, but if there are significant changes in market conditions in the period prior to certification, the actuary should consider using a later date [½]

- Assumptions – the actuary should use assumptions that are consistent with the Statement of Funding Principles [½]

- Benefits – the calculations should allow for discretionary benefits where the trustee determines that pre-funding is appropriate [½]

Certificate relating to proposed change to accrued rights of members

- Timing – the calculation will usually use an effective date shortly prior to the modification becoming effective. There are notification requirements which mean that post-modification certification is not possible [½]

- Assumptions – usually the calculations are undertaken using cash equivalent transfer value assumptions [½]

- Benefits – discretionary benefits will be taken in to account if they are reflected in cash equivalent transfer value calculations [½]

Bulk transfer certificate

- Timing – any calculation work will usually be undertaken using an effective date shortly before the transfer date [½]
- Assumptions – these are likely to represent the actuary's realistic view of future experience (without significant margins for prudence) although can be subject to negotiation [½]

- Benefits – continuation of discretionary benefits and member option terms should be considered [½]

Refund of surplus certificate

- Timing – the certificate should be provided based on an effective date shortly before the surplus refund is made [½]

- Assumptions – should the estimate of the buyout cost have regard to actual market quotations or be based on rules of thumb provided by the actuary's employer? [½]

- Benefits – those payable were the scheme to wind-up should be taken in to account [½]

[Max 6]

(iii) General

- Assumptions set in line with Statement of Funding Principles [½]

- And Trust Deed & Rules [½]

- Overall basis has to be set prudently rather than every assumption [½]

- Dependent on sponsor covenant [½]

- And funding position [½]
- Start with best estimate and build in margin [½]

Discount Rate

- can have regard to the investment return expected to be generated from the scheme assets [½]
- market related
- depends on valuation method
- both existing and as they are expected to change as the scheme matures [½]
- e.g. the gross redemption yield for fixed interest securities [½]
- and dividend and sale proceeds from equities [½]
- with an explicit reduction as a margin for prudence [½]
- and may vary for the period prior to retirement (reflecting a higher percentage of growth assets) [½]
- and for the period after retirement (reflecting a higher percentage of matching assets) [½]
- or can be generated based on the "risk free" returns available from matching government bonds [½]
- determined on a yield curve basis relating to a replicating notional portfolio [½]
- which would be very prudent [½]
- so there is a potential to increase the yield to allow for the risk premium relating to other more risky assets [½]
- but not to the full extent that a best estimate return is adopted [½]
- using stochastic modelling techniques, a confidence level can be calculated to indicate the level of prudence in the discount rate [½]

Earnings Growth

- important to base on discussions with employer [½]

- general earnings growth and an element of expected career progression by means of promotion [½]
- for example, there may be published pay scales with earnings increments based on service [½]
- consider real salary growth, the gap between inflation and salary growth [½]
- historic national earnings inflation statistics should be considered [½]
- although lower real rates have been experienced since the economic downturn in 2008/9 [½]
- note these can be tailored to reflect the industry of the sponsoring employer [½]
- and occupation of different members [½]
- input from management should also be considered (e.g. in relation to short term pay rise constraints) [½]
- it may be acceptable to fund on the basis of lower than expected earnings growth (e.g. equal to price inflation) for a mature scheme with a very strong covenant [½]
- on the basis that additional contributions are paid whenever relatively high earnings growth is experienced [½]

Mortality in retirement

- note a separate assumption is usually made for current experience (base table) and future improvements [½]
- in relation to the base table, inputs could include the following:
    - actual experience of pensioner members of the scheme (if it is large enough to produce statistically credible information) [½]
    - or adjust standard table [½]
    - current experience of the population as a whole or a subset of the population (e.g. insured lives) [½]

Consider;

- postcodes [½]
- size of salary/pension [½]
- socio-economic factors e.g. occupation [½]

- medical information *(with explanation)* [½]

- separate assumption for spouse [½]

in relation to future improvements, most schemes use assumptions that:

- are in line with the CMI Mortality Projection Model [½]

- using the core parameters and a long term improvement rate of between 1–2% p.a. [½]

- in the past, the Pensions Regulator has been concerned that the mortality assumptions adopted by some schemes have not been sufficiently prudent, and it is unlikely that an assumption based solely on historic tables or with no or only a modest allowance for future improvements would be considered to have been set prudently. [½]

[Max 16]

(iv) **General**

- Why is the employer suggesting this? [½]

- Need to review employer covenant [½]

- What is the view of Trustees, and the powers? [½]

- *Any sensible calculation of impact for each suggestion* [1]

Commutation assumption

- based on recent market conditions, it is likely that commuting pension on these terms would cost less than reserving for the equivalent pension benefit [½]

- therefore, it is relatively less prudent to make an assumption based on a very high level of take up [½]

and the actuary may be concerned that the proposal assumes the maximum lump sum benefit is taken by all members retiring under the scheme [½]

- since this will anticipate valuation gains that may not be generated in the future if take up rates turn out to be lower [½]

- it is also possible that the commutation terms will be reviewed in the future [½]

- and 11:1 is a relatively low rate of exchange so any review is likely to be upwards [½]

- although it is possible that the terms are specified in the rules of the scheme and not subject to review [½]

- nonetheless, it is possible that the actuary may be comfortable with the proposal [½]

- if current experience is that all members do take the maximum cash lump sum and [½]
- there is sufficient prudence in other valuation assumptions [½]

Enhanced transfer value proposal

- the actuary is likely to have a number of concerns with this proposal including the following: [½]
  - who meets the cost of the exercise? [½]
  - impact on technical provisions not likely to be too significant [½]
  - in general, whenever a member accepts a transfer value that is lower than the valuation reserve, a valuation gain is generated [½]
  - however, the exercise has not happened yet [½]
  - so the proposal is allowing for potential future valuation gains that are uncertain [½]
  - especially if trustees do not back proposal [½]
  - in particular, the benchmark take up rate of 30% is not necessarily a good guide for this scheme [½]
  - since this will depend on the actual enhancement offered [½]
  - and the communication/advice offered to eligible members [½]
  - further 85% of the valuation reserve may not cover the cash equivalent transfer value (cetv) for the member [½]
  - (particularly those closest to retirement who will have relatively high liabilities) [½]
  - And have highest CETVs compared to valuation liabilities [½]
  - and the transfer payment would, in any event, need to be adjusted to reflect post valuation experience [½]
  - and the proposal is 'circular' since the enhanced transfer value depends on the valuation reserve which depends on the allowance made for the enhanced transfer value [½]
  - in practice, the uplift compared to the cetv for different members would vary by age [½]

  - o with a relatively high uplift for younger members (who would have relatively low liabilities) [½]

  - o and for actives where salary growth is allowed for in technical provisions [½]

  - o so a uniform take up rate would not be appropriate [½]

- nevertheless, it is possible that the actuary could make some allowance for this exercise in the valuation [½]

- once further information about the proposal (e.g. whether advice will be provided to members free of charge) has become available [½]

[Max 10]
[Total 38]

> *Parts i and iii were reasonably well answered. However, in part i some of the answers did not relate to <u>actuarial certificates.</u>*
>
> *Part ii would have been easier if set out in the order of the 6 answers to part i, but a lot of candidates did not do that.*
>
> *For part iii, the better candidates covered a sufficient range of points needed to score well on this question with an emphasis on the issues to be considered rather than theoretic calculations.*
>
> *Part iv was generally well answered by the better prepared candidates, who again focussed on the specific factors relating to the company proposal.*

Q3 (i) (a) **For SPA after 6 April 2016**

- a flat rate pension payable to all individuals with sufficient qualifying contributions [½]

- equal to £159.55 per week for 2017/18 [½]

- no benefit is payable for individuals who have not made qualifying NI contributions for a period covering at least 10 years [½]

- and the full pension is payable if such contributions have been made for a period at least equal to 35 years [½]

- with a pro-rata approach being taken for those making qualifying contributions for periods between 10 and 35 years [½]

- and with a potential deduction in relation to periods of contracted-out service prior to 6 April 2016 [½]
- the pension is payable from State Pension Age [½]
- which is currently age 65 for men and will be 65 for women from 2019 [½]
- although it is expected to increase to 67 by 2026–28 [½]

[allow flexibility in previous 2 answers]

- and move in line with life expectancy thereafter (five yearly review periods) [½]
- the pension will increase annually in payment in line with the triple lock [½]
- i.e. the higher of (price inflation, wage inflation, 2.5%) [½]

(i) (b) **For SPA before 6 April 2016**

- a flat rate pension is payable to all individuals with sufficient credited NI qualifying contributions [½]
- including credited contributions [½]
- known as the Basic State Pension and equal to £122.30 per week for 2017/18 [½]
- although a higher pension is payable to a married person where the spouse does not claim/qualify for the Basic State Pension [½]
- the full BSP requires qualifying contributions for at least 30 years (retirees after 6 April 2010) [½]
- and increases in line with the triple lock described above [½]
- an Additional State Pension is also payable to those who made, together with their employer, the necessary national insurance contributions [½]
- known as the State Second Pension (2002–16) and the State Earnings Related Pension (prior to 2002) [½]
- the S2P has higher accrual for lower earners [½]
- the S2P increases in line with CPI once in payment [½]

[Max 8]

(ii) General

- the new State Pension is greater than the Basic State Pension, so most people should gain [½]

- especially if contracted-out or Additional State Pension low [½]
- less NI contributions required for higher benefit [½]

Net winners will include:

- anyone who has taken some time off compared to someone who works for the maximum potential period [½]
- or have not paid the full NI contributions [½]
- which could include those who retire before SPA [½]
- and those who take time off for caring or to look after children [½]
- older workers generally stand to gain compared to younger people who have just entered the workforce [½]
- including older women [½]
- who may only enjoy partial credits for some historic service [½]
- and older low earners [½]
- self-employed workers are generally winners (as not contracted-out) [½]
- since they now qualify for the new State Pension [½]
- without having to pay higher contributions for historic benefits [½]
- anyone who stays single benefits compared to married couples who lose certain rights [½]
- those who have previous contracted-out service generally win compared to those with comparable contracted-in service [½]
- public sector workers will benefit because they will receive a higher State Pension for a modest increase in National Insurance contributions [½]
- low earners may benefit as additional State Pension is low [½]

[Max 6]

(iii)

- there are no restrictions on the amount of contributions that can be made to a pension scheme [½]

- or to the benefit that can be taken from such a scheme [½]
- but there are differences to the tax treatment of such contributions and benefits [½]
- and limits on the extent to which concessionary tax treatment is available [½]
- in order to qualify for concessionary treatment, an arrangement must be registered with HMRC [½]

the concessions relating to contributions include:

- employer contributions are deductible as a business expense [½]
- employee contributions are deducted from gross earnings (i.e. before tax is applied) up to certain prescribed limits [½]
- likewise contributions can be paid by third parties without incurring tax up to certain prescribed limits [½]
- employer contributions are not subject to National Insurance contributions [½]
- employer contributions are not taxed as a benefit in kind for employees [½]
- individual personal contributions are limited to £3,600 p.a. or 100% of earnings if higher for tax relief [½]

the concessions relating to benefits include:

- lump sum death benefits (where the recipient is at the discretion of the trustees) are not subject to tax [½]
- lump sum benefits (up to a prescribed limit) are free of tax [½]
- contribution refunds (up to £20,000) are paid at low rate (currently 20%) [½]

the concessions available to investments include:

capital gains are not taxed [½]

investment income is not taxed (although any part relating to share dividends is effectively subject to corporation tax rates) [½]

the total benefit enjoying concessionary tax treatment accrued in a prescribed year under all registered schemes for any individual is limited to the Annual Allowance (AA) [½]

for the 2017/18 tax year, the AA is £40,000 [½]

for the purpose of calculating the AA, the value of benefit is determined as the amount of contributions (employee and employer) paid in to a DC scheme plus [½] the amount of incremental DB pension (with CPI revaluation on the starting amount) multiplied by 16 plus [½]

the amount of incremental lump sum benefit under a DB scheme [½]

any unused AA for the three previous years can also be carried forward in to the calculation [½]

in addition, the total benefit enjoying concessionary tax treatment accrued over an individual's lifetime under all registered schemes is limited to the Lifetime Allowance (LTA) [½]

for the 2017/18 tax year, the LTA is £1m, [½]

subject to CPI revaluation from April 2018 [½]

for the purpose of calculating the LTA, the value of benefits is determined as the balance of any DC fund plus [½]

the amount of post commutation DB pension multiplied by 20 plus [½]

the amount of any lump sum benefit [½]

the Money Purchase Annual Allowance can apply when accessing money purchase pots flexibly [½]

which is £4,000 for 2017/18 [½]

Annual Allowance is reduced if MPAA exceeded [½]

Lifetime ISAs are also tax efficient options [½]

Savers need to be over a8 and under 40 to start one [½]

Can save up to £4,00 p.a. up to age 50 [½]

Government will pay 25% bonus, up to £1,000 each year [½]

There is a 25% charge to withdraw cash [½]

Unless it is for buying you first home, or [½]

Retiring, age over 60, or [½]

Terminally ill, less than 12 months to live [½]
[Max 12]

(iv) **UK State Pension**

- generally, where an individual is accruing a full UK State Pension, the impact will be to reduce the amount of occupational pension provision [½]
- to reflect a target Net Replacement Ratio [½]
- resulting in lower rates of employer contributions to DC arrangements [½]
- and lower benefit e.g. rates of accrual under DB arrangements [½]
- however, until April 2016, it was possible for schemes to contract-out of part of the UK State Pension [½]
- and such schemes generally offered higher benefits [½]
- and were required to meet minimum benefit standards (payment of a Guaranteed Minimum Pension or those of a reference scheme) [½]
- reflecting the lower rate of National Insurance contributions that were then required to be paid [½]
- some DB schemes were designed to "integrate" with the UK State Pension [½]
- for example, through the use of pensionable earnings offsets equal or similar to the Basic State Pension [½]
- Normal Retirement Age in schemes was generally set to State Pension Age [½]
- Schemes had bridging pensions payable until State Pension begins [½]

Tax concessions

- occupational pension schemes have been designed to offer the full range of benefits enjoying concessionary tax treatment referred to above [½]
- e.g. discretionary death lump sums [½]
- 25% tax free cash at retirement [½]
- and many continue to restrict benefits to the maximum permitted under previous tax regimes [½]
- reflecting the relatively recent introduction of the AA and LTA (meaning that historic restrictions have not yet been removed) [½]
- some occupational schemes have been amended so that it is impossible to accrue benefits under that scheme in excess of the AA [½]

- and others have been amended so that personal taxes arising through accrual of pension in excess of the AA and/or LTA is financed by means of a reduction to the pension payable by the scheme [½]

- this sort of arrangement is known as Scheme Pays [½]

- other that in certain circumstances (e.g. serious ill-health) it is not possible to draw a pension until age 55 under an occupational pension scheme [½]

- Schemes were often made contributory as members get tax concessions on contributions [½]

- Salary sacrifice is often used to take advantage of tax concessions [½]

[Max 6]
[Total 32]

Question 3 was largely a bookwork question and the better prepared candidates scored well in parts i and iii. The better answers included sufficient detail compared to the number of marks available, particularly with the marks available under part iii. For example, many candidates missed out the LISA in part iii, which would have been straightforward marks.

Candidates seemed to struggle with part ii. Thinking about the answer to part i could have helped candidates work out the answer to this from first principles.

In part iv, many candidates did not make sufficient points to score well.

END OF EXAMINERS' REPORT