The Trustee toolkit downloadable

Introducing pension schemes

Tutorial two: Benefits

By the end of this tutorial you will better understand:

- types of beneficiaries under the scheme
- various options for providing benefits at pension age, divorce or death of the member

This tutorial is part of **Scenario one**.

Glossary

A detailed glossary of technical terms can be downloaded from the Resources tab when you log in at **www.trusteetoolkit.com**

The Pensions Regulator

Beneficiaries

Beneficiaries are the people entitled to benefits from the scheme. They include the members of the scheme and their dependants.

Active members

Active members currently work for the sponsoring employer and are accruing benefits under the scheme, and usually pay contributions to the scheme.

Deferred members

Deferred members are those who have stopped accruing benefits in the scheme but who are not yet receiving a pension from the scheme. There are two types of deferred members, those who:

- no longer work for the sponsoring employer
- are still working for the sponsoring employer, but have stopped accruing benefits in the scheme

Pensioner members

Pensioner members are members who are already receiving their benefits. When a member of a DC scheme accesses their benefits, their 'pot' is usually transferred out of the scheme and they cease to be a member.

Most DC schemes therefore only have active and deferred members (although some DC schemes purchase an annuity in the name of the scheme and therefore have pensioner members).

Dependants

Dependants are usually defined in the scheme rules. Dependants of a member can receive benefits from a pension scheme if the member dies. They are usually spouses, civil partners and children, but can also include divorced and separated spouses, long-term partners and other people who financially dependent on the member at the date of the member's death (for example siblings, parents and step-children).

Usually children of members are only considered to be dependants until the rules state that they become independent adults. Often this is determined to be at age 18, or when they cease to be in full time education, subject to an upper age limit of 23 in most cases.

Benefits

Pension schemes offer a variety of different benefits to their members but DB and DC schemes differ in one key way. Take a look at the descriptions below. Can you identify which is defined benefit and which is defined contribution?

1. Scheme members will receive pensions that reflect the benefits that they have earned by the time they left the company. These benefits are usually determined by length of service, salary and the accrual rate of the scheme
2. Scheme members will receive pensions which reflect the income they can buy with their 'pot'. The pot is made up of contributions paid to the scheme and the investment return on those contributions, less any charges.

Answers are at the back

Benefits for DB members

Gerald

Gerald retired earlier this year and started receiving a scheme pension. This means that he gets a certain amount of money each year which is determined by the rules set out in the scheme's rules.

Gerald thought about taking early retirement, but found out that he would be getting less money than he does now. So he decided to wait until he was 65, which is the normal pension age for his scheme (set out in the trust deed and rules). He was also offered two choices:

- a full pension
- a tax-free lump sum and a reduced pension

Gerald chose to receive the second option, although getting this lump sum up front meant that the pension he received was less than if he had chosen option one.

Damien

Damien has recently left a job after nearly ten years. He had accumulated DB pension benefits in that scheme that were worth some money. He could either:

- leave his benefits in his previous employer's scheme until he reaches pension age (ie defer his DB pension benefits with that employer)
- transfer the value of his benefits money to a personal pension arrangement (DC)
- transfer the value of his benefits to his new employer's occupational (DC) pension scheme to continue building benefits in one scheme

He asked his old scheme for a quote to say how much those accumulated benefits were worth. The quote is called the transfer value.

When he had that, he took independent financial advice and decided to keep the money with his old scheme and retain the benefits he had built up so far. He also decided to start paying contributions to his new employer's scheme in order to build up further benefits.

Henrietta

Henrietta joined the pension scheme at the company where she was working as soon as she was eligible, but she realised that the job was not for her and left the company and the scheme two months later.

Because she had only been in the scheme a short time, under her scheme rules she could not claim for a transfer or a deferred benefit. Instead, the scheme rules provided for the contributions she had made (less tax) to be returned to her.

Benefits for members of DC schemes

Colin

Colin had thought about taking early retirement, but chose not to as he would get less. This was because:

- his pension pot would have had fewer contributions paid into it, and it would have had less time to grow
- the younger he was, the lower the benefits were likely to be, because he would need it paid for a longer period

Colin had various options to choose from when he wanted to access his benefits.

> You can learn more about these options in the Tutorial: 'Decisions at pension age' in the Module: 'How a DC scheme works (2014)'.

Lee

Lee has recently left a job after nearly ten years. He had accumulated a DC pension pot in his previous employer's pension scheme. Under the rules of the previous employer's pension scheme he could:

- leave the value of his pension pot in his previous employer's scheme until he reaches pension age and then use the value of his pot to secure pension benefits (if he does this he will have 'deferred' benefits under his previous employer's scheme)
- transfer the value of his pension pot to a personal pension arrangement (DC) until he reaches pension age and then use the value in his pot to secure pension benefits (if he does this he ceases to be a member of his previous employer's pension scheme)
- transfer the value of his pension pot to his new employer's occupational (DC) scheme (and cease to be a member of his previous employer's scheme) in return for an increased pension pot in the new scheme. He can then use the consolidated pot to secure pension benefits

He asked his old scheme for a quote to say how much those accumulated benefits were worth. That quote is called the transfer value.

When he had that, he took independent financial advice and decided to transfer the value of his pension pot to his new employer's pension scheme. The increased pension pot takes account of the value of the transfer in, combined with the pension benefits paid by his new employer.

Gemma

Gemma joined the pension scheme at the company where she was working in October 2015, as soon as she was eligible, but she realised that the job was not for her and left the company and the scheme three weeks later.

Because she had less than 30 days pensionable service she had no statutory right to a transfer out or to a deferred benefit. However, under the scheme rules she was allowed a refund of her contributions less tax.

Benefits on death of the member

Dependants can also benefit from pension schemes following the death of an active, deferred or pensioner member.

Death in service

The most common form of additional benefit offered by pension schemes is a form of life assurance, also known as 'death in service' benefits.This means that if an active member dies, the dependants of that member will receive benefits from the pension scheme.

Expression of wish

The member should have filled in an expression of wish form stating how they would like the benefits to be distributed in the event of death. The trustees distribute the benefits at their discretion, taking the expression of wishes into account, but they are not bound by it.

Taxation

Because the allocation of these benefits is discretionary they are not classed as part of the member's estate, so are not subject to inheritance tax.

What benefits may be available?

Death in service benefits will vary depending on the scheme, and how long the deceased member was part of it. They can include:

- a lump sum, typically of three to four times salary at date of death
- a dependant's pension. In a DC scheme this will normally be purchased with an insurance company
- a return of contributions

Death in deferment

If a member dies after deferring their benefits in the scheme but before they have come into payment, the benefits payable on death will depend on the scheme rules.

In DC schemes the benefit may be a return of the member's contributions or a return of the member's pot.

In DB schemes the benefits may include a spouse's, civil partner's and/or dependant's pension, and/or a return of the member's own contributions.

Benefits on divorce

If a member gets divorced then their ex-spouse could still be a beneficiary of the scheme. The parties may apply to court for a pension sharing order or an earmarking order which sets out how the member's pension is to be treated as a result of the divorce.

Earmarking order

If the divorce settlement includes an earmarking order then the former spouse will receive some of the member's pension pot (DC), or pension and/or lump sum (DB) once the member assesses their benefits.

Pension sharing order

If the divorce settlement includes a pension sharing order then the former spouse will receive a portion of the value of the member's benefit at the date of the order.

Example

Mrs Jackson is a member of her company's pension scheme. She has recently been divorced. At the request of the parties, the court issued a pension sharing order and Mr Jackson will receive a portion of the value of his ex-wife's pension at the date of the order. In a:

- DC scheme, it would be a portion of the value of the member's pension pot
- DB scheme it would be a portion of the transfer value of the member's pension

It is possible for a pension sharing order to specify that the whole of the value of a member's pension to be allocated to their ex-spouse.

The scheme does not have to provide a deferred benefit for Mr Jackson. They can insist, in most circumstances, that he transfers his portion to a different pension arrangement of his choice.

Answers and feedback

Benefits

The first scheme is DB and the second scheme is DC.

In a DB scheme the amount of pension the member will receive (the benefit) is fixed by reference to a member's pensionable salary and length of service, eg 1/80th of pensionable salary for each year of active membership, but the level of employer, and sometimes employee, contributions required to meet the agreed pension is variable.

In a DC scheme, the contributions are known from outset but the amount of pension that will be payable is variable and unknown.