FREEDOM AND CHOICE IN PENSIONS

A DECONSTRUCTED GUIDE

icaew.com/pfp

WELCOME

Welcome to our technical guide Freedom and Choice in Pensions, which ICAEW has produced in collaboration with Prudential PLC.

This updated guide incorporates recent legislative changes. It is designed to help professional advisers, and individuals, have a better understanding of the details and implications of this complex area.

It is estimated around 400,000 individuals with money purchase pensions will reach the age of 65 over the next few years as the baby boomers hit retirement age. Around 14.7m people in the UK are over 60 years of age, and 22.7m are over 50.

Whether Freedom and Choice in Pensions delivers outcomes that are consistent with the long-term public interest remains to be seen. However, demographics and a liberalised regime means there is a growing need for good quality professional advice in this increasingly important area. ICAEW Chartered Accountants and other professional advisers need to keep fully up to date in this complex area of advice.

Greater complexity and increasing emphasis on self-provision, provides ICAEW Chartered Accountants with an excellent opportunity to develop business in this area by working more collaboratively with specialist financial and investment advisers to help deliver a more integrated service proposition.

In recognition of these developments, ICAEW has a Personal Financial Planning Community. This online community is open to ICAEW Chartered Accountants, and others with an interest in this sector of the professional advice market. The Community can be accessed without charge.

Full details of the ICAEW PFP Community can be found at icaew.com/pfp

John Gaskell
ICAEW Head of Personal Financial Planning
john.gaskell@icaew.com

John Gaskell

SHORT TECHNICAL GUIDE TO THE FREEDOM AND CHOICE PENSION REFORMS

INTRODUCTION

In his Budget speech on 19 March 2014, the then Chancellor of the Exchequer George Osborne argued the introduction of Freedom and Choice in Pensions represented the most fundamental change to the way people can access their pension savings in almost a century. Whatever the outcome of the pension reforms, their introduction represented a watershed in the UK savings landscape.

Greater choice in the way that people can access their pension savings and the removal of the effective need to buy an annuity comes at a price. Freedom and Choice in Pensions means that individuals and professional advisers will have to shoulder more responsibility for managing the financial implications of longevity in the new savings regime.

This technical guide provides an overview of the main details of the pension reforms and additional changes introduced in subsequent Budgets. We will also look at advice and guidance issues that have arisen since pensions freedoms were introduced.

The main areas of the pension reforms

- Introduction of flexi-access drawdown – drawdown without limits for all.
- Introduction of more flexibility for annuities.
- Introduction of an uncrystallised funds pension lump sum (UFPLS) – a new mechanism to withdraw lump sums from a pension.
- Introduction of the money purchase annual allowance (MPAA) – a restriction on the annual allowance for people who access their pension flexibly.
- Changes to pension commencement lump sum recycling rules.
- Changes to death benefits – including improvements in the tax position and the potential to cascade wealth down the generations.

Since freedoms were introduced, there has been subsequent legislation that introduced:

- alignment of pension input periods to tax years, which had transitional provisions;
- a tapered reduction in annual allowance for higher earners from April 2016.
- a reduction in the lifetime allowance (LTA) from April 2016, a subsequent increase and it's currently frozen until 2025/26.

In this updated guide we look at the detail in four of the key areas:

- death benefits
- pension transfer advice requirements
- lifetime allowance
- annual allowance.

FLEXI-ACCESS PENSIONS

What is a flexi-access pension?

- Flexi-access drawdown is the only drawdown option since 6 April 2015 unless the individual was in capped drawdown before that date.
- For those that were in flexible drawdown as at 5 April 2015, they automatically became flexi-access drawdown on 6 April 2015.

Flexi-access drawdown operates in the same way as flexible drawdown did before 6 April 2015 (ie, there is no limit on income withdrawals), but without the minimum income requirement of £12,000 of other secure pension income in a tax year to access it. The individual may decide how much or how little of their fund they wish to take as income, and when they want to take it. They may also take a 25% pension commencement lump sum (PCLS) and designate the rest of the fund into flexi-access drawdown. Any withdrawals taken above the 25% PCLS will be taxed at the individual's marginal rate and are counted as a trigger event for MPAA purposes. See below for more details on MPAA.

TIP	Sustainability of income will be a key objective for many individuals. The income may need to continue for 25 years or more. To model some specific income assumptions, check out the Prudential Retirement Modeller on the PruAdviser website.

Capped drawdown

- Capped drawdown is no longer available for new arrangements.

However, capped drawdown arrangements (drawdown with income restrictions already in place on 5 April 2015) may continue under the existing rules. As long as the scheme allows, future designations to the same arrangement may continue. The MPAA will not be triggered if the income drawn remains within the maximum capped drawdown amount.

Recycling

Although recycling of income within the limits is fine, be careful with the recycling of any PCLS, as the limit is £7,500. All other rules/criteria remain the same and can be viewed at HMRC.

ANNUITY FLEXIBILITY

On 6 April 2015, three important changes were made to the annuity rules.

- A lifetime annuity may continue after the member's death for any period that is set out in the annuity contract (previously limited to a 10 year guarantee).
- A lifetime annuity can go down as well as up by any amounts (historically, this was possible only in limited circumstances). Although, as this is a lifetime annuity, there must still be an annual payment made to the member.
- The annuitant can name someone other than a dependant as a beneficiary, if the annuity provider allows this.

UNCRYSTALLISED FUNDS PENSION LUMP SUM (UFPLS)

- Eligible individuals can withdraw their full uncrystallised defined contribution pension fund or take partial withdrawals as required.
- Not all schemes will offer this feature.

One of the changes made by the Taxation of Pensions Act 2014 was the introduction of the UFPLS. Individuals no longer have to designate funds as available for drawdown, buy an annuity or take a scheme pension to extract money from a pension fund. Effectively it gives customers the ability to draw income from their pension without buying a product, such as income drawdown or an annuity.

To qualify to take an UFPLS the following applies.

- The individual must have reached normal minimum pension age or meet the ill-health conditions. More information on ill-health early retirement is available.[2] If under age 75, the individual must have lifetime allowance remaining which is equal to or more than the amount of the lump sum being withdrawn.
- If over 75, the individual must have some LTA left.

In addition, the UFPLS must be payable from uncrystallised rights held under a money purchase arrangement.

An UFPLS cannot be paid to someone who otherwise would not be entitled to a 25% PCLS eg, those who have tax free cash protection through primary or enhanced protection, their funds derive from disqualifying pension credits or those that have scheme specific protected tax-free lump sum rights.

How does an UFPLS work?

- Each UFPLS payment will normally be 25% tax free, with the remainder taxed as pension income.
- The tax-free element is not a pension commencement lump sum (PCLS). For a PCLS to exist there must be arising entitlement to income, for example through drawdown or an annuity. This means the tax-free element cannot be separated from the taxable element. It is worth noting that if an individual wishes to have tax-free cash and no income, drawdown is still the only option.

* If the Scottish rate of income tax applied this would produce a different net result..

TIP

The tax implications of taking an UFPLS can be quite considerable. If an individual (age 55) has a fund of £100,000 and wishes to access the full fund, they will get £25,000 tax free, with £75,000 taxed at their marginal rate. *If this is the only income they have, they will fall into higher rate tax and receive £82,568 (based on 2021/22 tax rates).

£25,000 tax free + £75,000 taxed. Tax (£12,570 x 0%) + (£37,700 x 20%) + (£24,730 x 40%) – £17,432, £100,000 – £17,432= £82,568.

However, if the same individual decided they wanted to take £10,000 UFPLS per annum for 10 years, until they reached state pension age, they would receive £2,500 tax free and £7,500 taxed at their marginal rate each year. If they had no other income, currently their personal allowance would cover that £7,500. By the end of the 10 years, they would have extracted £25,000 tax free and £75,000 taxed at 0%.

However, it is important to note that individuals may not immediately see the sums they expect due to the operation of their tax code and the PAYE system. It may well be that the provider will need to apply the emergency tax code to any withdrawals. In the example above, where the full amount is withdrawn, this could mean around an extra £14,600 tax, although any overpaid tax can be reclaimed: relevant forms are online at gov.uk/claim-tax-refund/you-get-a-pension

MONEY PURCHASE ANNUAL ALLOWANCE (MPAA)

What is the MPAA?

- It is designed to stop anyone abusing the new flexible pension rules to avoid tax and National Insurance contributions.
- The MPAA is a lower alternative annual allowance applied where flexibility has been accessed.
- When introduced, the MPAA was set at £10,000, but this limit was reduced to £4,000 as of 6 April 2007.
- It applies to contributions to money purchase pension schemes by or on behalf of the scheme member.
- A person still has an overall annual allowance of £40,000 so defined benefit pensions can still be accrued. The £40,000 is reduced to £36,000 in any year the MPAA is exceeded.

The rules allow those who have accessed flexibly (ie, triggered the MPAA, see list below) to continue to benefit from tax relief on money purchase contributions up to £4,000, per tax year, without incurring a tax charge. MPAA is actually a positive for some, as it's an improvement on the pre-6 April 2015 position, when the standard annual allowance for those in flexible drawdown was zero.

What triggers the MPAA?

Any of the following can trigger the MPAA.

- Uncrystallised funds pension lump sum.
- Flexi-access drawdown income – once income (or any lump sums from the designated pot) is taken from funds designated to a flexi-access drawdown plan.
- Existing flexible drawdown – before pensions freedoms this was an option for those that could meet a minimum guaranteed income requirement, at 6 April 2015 this automatically converted to flexi-access drawdown and the MPAA applied.
- Capped drawdown where income above the cap is taken.
- Stand-alone lump sum – when a stand-alone lump sum is paid to the individual and the individual has primary protection and a protected tax-free lump sum right which is greater than £375,000. The trigger event occurs immediately before that payment.
- Flexible annuity – an annuity that can vary in a way that was not permitted before 6 April 2015. The MPAA is triggered immediately before the first annuity payment.
- When a scheme pension starts that was set up after 5 April 2015 from a scheme with fewer than 12 pensioner members.

The MPAA will apply from the date that pension flexibility is accessed. However, it will only be relevant where total contributions to a money purchase arrangement in the tax year exceed £4,000.

Can the MPAA be avoided while maintaining access to pension funds?

Yes, but only in these limited circumstances.

Small pots

- Three arrangements of up to £10,000 each can be withdrawn from non-occupational pensions subject to small pots rules. This is paid 25% tax free and 75% at marginal rate in the same way as an UFPLS. However, a small pots payment does not trigger the MPAA and is not a benefit crystallisation event. For occupational pensions the small pots rules still apply, although there is no cap on the amount of times that this can be used.

PCLS and nil-income

- Where an individual needs capital but wants to continue paying pension contributions, a PCLS can be paid with the balance being vested to flexi-access drawdown. This will not trigger the MPAA until income is taken from the drawdown plan.

Disqualifying pension credit use

- While a client will have no access to PCLS from a Disqualifying Pension Credit (as the ex-spouses' pension was already in payment there would be no further access to PCLS), any income taken wholly from a Disqualifying Pension Credit means that the MPAA will not be triggered.

Accessing benefits non flexibly

- As long as the flexible access detailed above is avoided then a member will not trigger the MPAA. An example of this is taking a non-flexible annuity.

CARRY FORWARD

The simplest method of maximising pension contributions is to join a scheme as early as possible so that unused annual allowance can be carried forward to future years (once the current year's annual allowance has been used, up to three prior yEars unused allowance can be carried forward).

REDUCED ANNUAL ALLOWANCE FOR HIGHER EARNERS (FROM 6 APRIL 2016)

In April 2016 a taper to the annual allowance was introduced for those with 'high earnings'.

It should be noted that adjusted income is a wholly different measure of income to the more familiar adjusted net income.

What does this mean?

The tapered annual allowance was introduced from 6 April 2016. For the taper to apply, the limits on threshold income and adjusted income must both be exceeded.

For every £2 of adjusted income over £240,000, an individual's annual allowance (the limit on the amount of tax relieved pension savings that can be made by an individual or their employer each year) will be reduced by £1, down to a minimum of £4,000.

Before the 2020/21 tax year, lower limits applied and for every £2 of adjusted income over £150,000, an individual's annual allowance was reduced by £1, with the minimum annual allowance being £10,000.

It should be noted that adjusted income is a wholly different measure of income to the more familiar adjusted net income.

Adjusted income is broadly the individual's net income plus the value of certain pension savings for the tax year, but less the amount of certain lump sum death benefits paid to the individual during the tax year.

TIP	Not everyone will want to take money out of a pension scheme and pay it back in again, but for those who do, it is critical the individual fully understands the implications of the MPAA and the tax charges that can apply if this is exceeded.

Here is an explanation of adjusted income.

- The individual's net income for the year (step 1 and 2 of the calculation in section 23 of the ITA 2007).

Step 1

- Identify the amounts of income on which the taxpayer is charged to income tax for the tax year. The sum of those amounts is total income. Each of those amounts is a component of total income.

Step 2

- Deduct from the components the amount of any relief under a provision listed in relation to the taxpayer in section 24 to which the taxpayer is entitled for the tax year. See section 25 for further provision about the deduction of those reliefs. The sum of the amounts of the components left after this step is net income.

Income Tax Act note – section 24 and 25 are accessible.

Plus:

- excess relief under net pay and relief on making a claim;
- the amount of any pension contributions made from any employment income of the individual for the tax year under net pay;
- UK tax relief on overseas pensions;
- value of employer contributions:
  - money purchase = value of contributions,
  - defined benefit = pension input amount minus member contributions.
- Less the amount of any lump sum death which accrues to the individual in that tax year.

Where an individual is below the threshold income limit, they cannot be subject to the tapered annual allowance.

Threshold income is broadly defined as the individual's net income for the year less any pension contributions made under Relief at Source (RAS), less the amount of any lump sum death benefits paid to the individual during the tax year that can be deducted from the adjusted income.

In more detail, threshold income is:

- taxable income for the tax year;
- less any lump sum benefits accruing in the tax year (ITEPA03 636A-4ZA);
- plus employment income given up for pension contributions (ie, salary sacrifice) on or after 9 July 2015;
- less the gross amount of any relief at source (to ensure that when calculating threshold income, there is parity between any contributions made under net pay, which are deducted arriving at taxable income, and relief at source).

CHANGES TO PENSION INPUT PERIODS

Pension input periods are the period over which an individual's Annual Allowance use is measured. It is currently the tax year but in the past the PIP was not necessarily aligned to the tax year.

- In the July 2015 Budget, the Chancellor announced that all open pension input periods (PIP) would close on 8 July 2015, all pensions would then be given a further PIP starting on 9 July until the end of the tax year. Members were also prevented from nominating their own PIP at this time. This change in the rules was required in order to be able to administer the tapering of annual allowance now that the annual allowance is directly linked to the tax year through the adjusted and threshold incomes outlined above.
- Contributions made in excess of £40,000 in the period before 8 July 2015 are tested against the annual allowance for 2015–16. Transitional rules were introduced to ensure that, in these circumstances, prebudget savings of up to £80,000 were protected from an annual allowance charge.

New arrangements which started on or after 9 July 2015 and on or before 5 April 2016: the pension input period started on the normal commencement day and ended on 5 April 2016.

The 2015–16 tax year was split into two mini tax years for the purpose of annual allowance, the pre-alignment tax year and the post-alignment tax year. This is still relevant when working out carry forward from 2015-16.

Pre-alignment tax year

Individuals had an £80,000 annual allowance (plus any available carry forward from 12/13, 13/14, 14/15) for all their pension savings in all pension input periods ending on or after 6 April 2015 and on or before 8 July 2015.

Post-alignment tax year

Savings from 9 July 2015 to 5 April 2016 had a nil annual allowance, but up to £40,000 of any unused annual allowance from the period up to 8 July 2015 is added to this. This assumes they were a member of a registered pension scheme during the period 6 April 2015 and 8 July 2015 and had not triggered the MPAA. Those who were not a member of a registered pension scheme during the period 6 April 2015 to 8 July 2015 will have an annual allowance of £40,000 for the period 9 July 2015 to 5 April 2016. Someone who joined a scheme for the first-time after the Summer 2015 Budget will effectively work on normal rules.

DEATH BENEFITS

The knife edge – defined contribution pension schemes

Historically, the tax position of a lump sum death benefit depended on whether the fund had been crystallised or not. This broadly meant that once a pension commencement lump sum (PCLS) had been taken the death benefits would be poorer. For example, an individual aged 60 at death could usually leave their uncrystallised personal pension fund to a dependant free of tax, but a drawdown plan would attract a 55% tax charge (the special lump sum death benefit charge).

Under the new rules, the main factor is the age of the member. If the member dies under age 75, the benefits can generally be paid tax free to a chosen beneficiary (with some restrictions, discussed later). For members aged 75 and above, income and lump sums paid will be taxed at the beneficiary's marginal rate. Lump sums will continue to be taxed at 45% when paid to non-individuals eg, trusts, estates etc. If the ultimate beneficiary is an individual they may be able to reclaim tax. See Trusts and taxes and Death benefits from defined contribution schemes.

Who can benefit?

The Taxation of Pensions Act 2014 introduced two new types of beneficiary drawdown, giving three types:

1. dependant flexi-access drawdown
2. nominee flexi-access drawdown
3. successor flexi-access drawdown.

On the member's death and where the beneficiary wants to draw an income, this will be through either dependant drawdown or nominee drawdown – depending on whether or not the beneficiary is a dependant (a dependant cannot use nominee flexi-access drawdown). After the death of the first beneficiary, the fund will become successor flexi-access drawdown, and remain successor flexi-access drawdown through subsequent beneficiaries.

Nominations

- A nomination means a beneficiary nominated via an expression of wish or by binding direction, where scheme rules permit and/or circumstances dictate.
- A nominee, for nominee flexi-access drawdown, includes any non-dependant nominated by the member, and any non-dependant nominated by the scheme if the member did not nominate a beneficiary.

However, the scheme cannot nominate anyone for nominee flexi-access drawdown if a dependant of the member is alive. For example, if the spouse is still alive, the scheme cannot nominate non-dependent children to receive income, but could choose to pay a lump sum benefit (although this could attract a higher tax rate – this is covered later).

TIP

The new rules give the potential for wealth to be cascaded down the generations – individuals should make sure schemes allow the full flexibilities on offer and that their nomination forms are up to date and reflect their wishes.

What is the tax position on death?

The tax will depend on the following.

- The member's age at death.
- Whether the funds have already been crystallised before death (for LTA excess purposes only).
- Designation/annuity purchase (ie, the fund being put in the name of the beneficiary) within the relevant two-year period starting with the scheme being notified of the death (or the date when the scheme could reasonably have known of the death).

There are three possible outcomes

- Tax free: no income tax is to be deducted from the payment.
- Marginal: the beneficiary will be liable for income tax at their marginal rate on the amount withdrawn.
- 45%: the special lump sum death benefit charge which is deducted if the member/beneficiary is over 75 (or under 75 and outside the relevant two-year period) and a lump sum is paid to a non-individual (eg, a trust).

Pre-75

Generally, where death is pre-75, the beneficiaries can access the fund tax free. However, this is true only for uncrystallised benefits where the benefits are designated, or annuity purchased for the beneficiary within two years of notifying the scheme of the death (the relevant period). If the time limit for setting up benefits is not met then any benefits taken are subject to marginal rate income tax for individuals and 45% for non-individuals. For crystallised benefits, if the member is under 75 and benefits aren't designated until outside of the two-year period then income will be tax free but lump sums will be taxed at marginal rate/45%.

Post-75

Where death is after the 75th birthday, tax is payable at the marginal rate for individuals and 45% for non-individuals. The two-year period has no impact on the income tax position.

Lifetime allowance and the two-year rule

For deaths pre-75, both income and lump sum benefits taken from uncrystallised funds within the relevant two-year period are tested against the LTA, currently £1,073,100. Designations outside of this period will not be tested against the LTA but will instead be taxed at marginal rate for individuals and 45% for non-individuals.

Inheritance tax

Inheritance tax (IHT) rules on when a pension fund will be counted in the deceased's estate have not changed. Generally, where the scheme member can bind the trustees to pay to a specified beneficiary who is not a dependant, it will be treated as part of the deceased's estate for IHT. But where the trustees can exercise discretion, the funds will generally be outside IHT assessment. Most schemes operate on an expression of wish basis (sometimes called a nomination of beneficiary) with the scheme administrator or trustees making the final decision.

Pension plans without discretionary disposal (such as retirement annuity contracts) will automatically fall into the deceased's estate.

There are further scenarios where a pension could be considered in the IHT assessment, but these are outside the scope of this document.

TIP

If benefits aren't taken within the two-year period but the member does want a lump sum, then it is wise to designate to drawdown but then withdraw the whole amount as a drawdown payment as this would be tax-free rather than taxed at marginal rate.

Defined benefit schemes

Pre-crystallisation

The scheme (or a separate arrangement) can, on the death of the member, pre-crystallisation and pre-75, pay a defined benefit funds lump sum. The lump sum will be specified by the scheme rules (HMRC doesn't specify any limit) and is tax free up to the value of the member's remaining lifetime allowance (BCE 7). Any lump sum payment above the LTA will be taxed at 55% tax in the hands of the recipient(s). In addition, scheme pensions usually pay a dependant's pension. The scheme rules will outline the amount of spouse's/civil partner's and/or children's pensions. Where a dependant's pension is paid through a scheme pension, the dependant getting the dependant's pension will be liable to income tax on the continuing pension payment, at his/her own rate of tax. [Although revisions have been made to annuities and drawdown taxation, making death benefit payments tax free on death before the age of 75 (pre- or post-crystallisation), this treatment doesn't apply to scheme pensions.

If the capital value of the dependant's benefits is under £30,000, under trivial commutation lump sum death benefits rules, the benefits can be paid as a lump sum. A trivial commutation lump sum death benefit is wholly taxable in the hands of the recipient.

Post-crystallisation

While it's possible for a scheme pension to provide a lump sum death benefit, after crystallisation, up to age 75 (via the scheme or through a separate insured arrangement), it's unusual for lump sum cover to continue after the retirement of the member. Benefits from a scheme pension on death post-crystallisation will usually be in the form of a dependant's pension – where a dependant's pension is paid from a scheme pension, the recipient will be liable to income tax on the continuing pension payment at his/her own rate of tax.

Where a dependant's pension is paid to the estate, before it is distributed to the beneficiaries under the deceased's will/the laws of intestacy, tax is deducted at the personal representatives' rate of tax (basic rate). When the dependent's pension is subsequently paid to the beneficiary, it will be classed as 'basic rate of tax paid' and will only be liable to further income tax if the beneficiary is a higher or additional rate taxpayer.

If a lump sum is payable pre-age 75 it is paid tax free as long as it is distributed by the scheme administrator within two years of the death. Pre-age 75 death benefits paid outside the two-year period and death benefits paid post-age 75, are taxable in the hands of the recipient.

There is no limit on the level of defined benefits lump sum death benefit that can be paid from a scheme.

Types of payment

The different types of death benefit are summarised below for reference.

Uncrystallised funds lump sum death benefit	A payment from uncrystallised pension monies within two years of being notified of the death of the member. The full value of the assets at the time of making the payment can be paid.
Flexi-access drawdown fund lump sum death benefit	A lump sum payment made on the member's death (or their beneficiary) from a flexi-access drawdown plan, but not a charity lump sum death benefit.
Trivial commutation lump sum death benefit	Where a beneficiary is entitled to a payment valued at up to £30,000 from a scheme, this can be taken as a trivial commutation lump sum death benefit. It must extinguish all of the rights under the scheme, both to an income and lump sums. This includes payments from an annuity under a guarantee period where the value is less than £30,000.
Annuity protection lump sum death benefit	A lump sum death benefit is an annuity protection lump sum where it is paid in respect of a scheme pension or a lifetime annuity arranged from a money purchase pension fund. The maximum that can be paid is the purchase price of the annuity less any gross income paid and less any other annuity protection lump sum already paid in respect of this annuity.
Charity lump sum death benefit	Where the member has no dependants, a charity lump sum death benefit may be paid: • from drawdown funds (member or a beneficiary); or • from uncrystallised funds to a charity nominated by the member.
Defined benefit lump sum death benefit	A lump sum paid in respect of a defined benefits arrangement where the member was aged 75 and above, or, if younger, for a payment after the relevant two-year period. x
Pension protection lump sum death benefit	Similar to annuity protection lump sum death benefit but in respect of a scheme pension from a defined benefits arrangement. Where the member asks, and the scheme agrees, this would allow a beneficiary payment up to the crystallisation amount less income paid.

Appendix C has a flowchart summarising distribution rules for pension death benefits from defined contribution pension schemes.

Below is a summary of the tax treatment of money purchase death benefits for individuals.

Age at death	Paid from	Benefit type	Relevant time	Tax	Subject to LTA test?
< 75 years	Crystallised	Income/Lump sum	< 2 years	Tax free	No
< 75 years	Crystallised	Income	> 2 years	Tax free	No
< 75 years	Crystallised	Lump sum	> 2 years	Marginal	No
< 75 years	Uncrystallised	Income/Lump sum	< 2 years	Tax free	Yes
< 75 years	Uncrystallised	Income/Lump sum	> 2 years	Marginal	No
=> 75 years	Crystallised	Income/Lump sum	< 2 years	Marginal	No
=> 75 years	Crystallised	Income/Lump sum	> 2 years	Marginal	No
=> 75 years	Uncrystallised	Income/Lump sum	< 2 years	Marginal	No
=> 75 years	Uncrystallised	Income/Lump sum	> 2 years	Marginal	No

TIP	Pensions provide a tax-efficient vehicle for passing wealth down through generations. The ability to pass on the fund tax free combined with the tax-free growth means that, even if subject to income tax in the hands of the beneficiary, it may still be attractive. Some may find their family situation demands greater control of the proceeds, but most may be content to allow the funds to remain in the pension wrapper as long as possible. These changes strengthen the perspective that pensions form part of all good IHT planning.

CASE STUDIES

A – Cascading wealth down the generations problem

Billy and Mary were married for many years and raised several children, some of whom have children of their own. Billy ran his own business for most of his life and built up a personal pension which he designated to capped drawdown when he retired two years ago. He then designated to flexi-access drawdown in April 2015 and he completed an expression of wish in favour of Mary.

Sadly, Billy dies in January 2017, aged 65. Mary wants to know her future income from her late husband's pension fund. Mary is also concerned about what will happen to the fund on her death.

Solution

As Mary was nominated by an expression of wish, the pension scheme will not be forced into paying to her. But where there are no compelling circumstances for payment to someone else, it is likely Mary will get the benefits. As Billy died aged under 75, Mary has the following choices:

1. take dependant's flexi-access drawdown and draw a tax-free income as necessary;
2. take a tax-free flexi-access drawdown lump sum death benefit; or
3. take a tax-free annuity or scheme pension.

Mary chooses dependant's flexi-access drawdown. This gives her a tax-free income from the dependant's flexi-access drawdown. She immediately completes an expression of wish in favour of her children. Mary survives until she is in her 90s. On her death, the scheme, having considered all the potential beneficiaries, offers her beneficiaries the following choices:

1. successor flexi-access drawdown with income taxed at marginal rate;
2. flexi-access drawdown lump sum death benefit, taxed at marginal rate; or
3. successors' annuity taxed at marginal rate.

Mary's children may wish to consider the size of the remaining fund and the impact this would have on their tax position if taken as a lump sum. Additionally, funds in successor drawdown are usually outside the successor's estate for IHT purposes. The children choose a charity for any residual pension fund on their deaths. The scheme can choose to follow this nomination or can pay a flexi-access drawdown lump sum to another beneficiary (but they cannot set up successor drawdown because of the charity nomination). Alternatively, the children could have nominated their own children and continued to cascade any residual funds through the generations.

B – A modern family problem

Mike and Sue (both aged 57) are married but separated and have been living apart for the past year. They have grown-up children with no financial dependency. Mike died unexpectedly in June 2016. He had not completed an expression of wish to the scheme setting out his preferences in the event of his death.

Solution

Sue, although estranged, still qualifies as Mike's dependant and therefore qualifies for dependants' flexi-access drawdown. She would also be eligible for a lump sum payment. As Mike was under 75 when he died, any lump sum would be tax free and (subject to the two-year rule) income would be tax free too.

The scheme would not be able to nominate Mike's children for income from nominee flexi-access drawdown. Where the member did not nominate anyone, nominee flexi-access drawdown cannot be set up for any non-dependant while there is a dependant. However, the scheme could choose to pay a lump sum benefit to the children, which could be paid tax free as Mike was under 75 (however, this would then form part of the children's estate for IHT purposes).

Valid and up-to-date nominations are essential to ensure that death benefits can be distributed in the most efficient manner and maximise the options for beneficiaries.

Information given is based on our current understanding (as at July 2021) of current taxation, legislation and HMRC practice, all of which are liable to change and subject to individual circumstances.

PENSION PLANNING: OPPORTUNITIES FOR ICAEW CHARTERED ACCOUNTANTS

ICAEW Chartered Accountants can help bridge the gap between pension guidance and advice and are well placed to provide financial planning to their clients. Working with specialist financial advisers who have detailed technical and product knowledge of the pensions market, they can offer clients an excellent integrated service to help them make fully-informed decisions on their pensions and retirement planning needs.

Most of ICAEW's 12,000 member firms limit their exposure to financial services by providing clients with details of a specialist financial adviser regulated by the FCA and avoiding any comment on the advice given.

What is not generally appreciated, however, is that ICAEW is a designated professional body (DPB). With a DPB (Investment Business) licence, ICAEW members can provide complementary advice on financial services matters to their clients. A DPB (Investment Business) licence allows ICAEW Chartered Accountants to:

- explain and evaluate the advice the client receives from a financial adviser;
- identify unsuitable advice from a financial adviser; and
- endorse the advice the client receives from a financial adviser.

A financial plan can be produced to explain how pensions can be used as an appropriate tax mitigation medium and the financial adviser can give specific product advice and arrange the transactions. This allows ICAEW members to provide an integrated service to their clients without surrendering complete control of the advisory process to a financial adviser. And, of course, as their accountant and trusted adviser, charge an appropriate fee.

Any firm that has an ICAEW Chartered Accountant as a principal can apply for a licence. The application process is easy and relatively quick and there are no additional qualification requirements. The cost is modest. In 2021 the annual fee for a sole practitioner with one office was £269 and for a firm with two or three partners in a single office it was £546.

The regulation is light touch; you will need to complete an annual compliance review, answer some additional questions in your online annual return, and DPB compliance checks take place with your Practice Assurance visit. To apply or for more details, please visit icaew.com/dpb or contact nick.reynolds@icaew.com

PERSONAL FINANCIAL PLANNING: TRAFFIC LIGHT GUIDE TO REGULATION

To help ICAEW Chartered Accountants and others navigate this complex area of regulation, ICAEW has produced a Traffic Light Guide to help professional advisers understand the nature of advice that can be provided with different levels of authorisation. The guide provides a useful starting point to signpost what type of advice can be offered in context of whether a firm holds an ICAEW Practising Certificate, DPB licence, or operates under a full FCA licence. icaew.com/trafficlightguide

Regulation deconstructed guide: www.icaew.com/groups-and-networks/communities/personal-financial-planning-community/personal-financial-planning-regulation/regulation-deconstructed

PERSONAL FINANCIAL PLANNING COMMUNITY

ICAEW has created an online Personal Financial Planning Community, known as PFP, to help support professional advisers who have an interest in the personal financial planning and investment advice sector. The Community is open to both ICAEW Chartered Accountant and other professional advisers, free of charge.

It provides access to a range of information and forthcoming events to help keep you up-to- date and develop business in this important sector of the professional advice market.
icaew.com/pfp

APPENDIX A

2021 SPRING BUDGET SUMMARY

The Spring Budget took place on 3 March 2021 and the key points are below.

PENSIONS

- Annual allowance, tapered annual allowance, lifetime allowance, pension commencement lump sum and tax relief are unchanged.
- The lifetime allowance is to remain frozen at £1,073,100 until 5 April 2026.

PERSONAL TAX

- Personal tax allowance is £12,570 for 2021/22, this is to remain frozen until 5 April 2026.
- Higher rate threshold is £50,270 in 2021/22, again this is to remain frozen until 5 April 2026.
- Different rates of taxation in Scotland apply for non-savings non-dividend income. For further information please read Scottish Rate of Income Tax – Facts

CAPITAL GAINS TAX

The rates of CGT in 2021/22 are:

- 10% for individuals where total taxable gains and income are less than the upper limit of the basic rate band (£33,700 + £12,570 = £50,270);
- 20% for individuals in respect of gains (or any part of gains) above that limit; and
- 20% for trustees and personal representatives.

The rates of 28% and 18% have been retained for gains on residential property.

The annual exempt amount remained at £12,300 for individuals (£6,150 for trustees) and is frozen until 5 April 2026.

INHERITANCE TAX

- The residence nil-rate band (RNRB) came into effect on 6 April 2017 and is now worth £175,000. It has a £2m threshold where tapering of this allowance starts. When this threshold is exceeded, the RNRB is reduced by £1 for every £2 of value by which an estate exceeds the taper threshold. Tapering can reduce the RNRB to zero.
- The nil-rate band for IHT remains at £325,000 per individual.
- The NRB, RNRB and the RNRB taper threshold will all remain frozen until 5 April 2026.

CORPORATION TAX

- The UK corporation tax rate will remain at 19% for the years starting 1 April 2021 and 1 April 2022.
- From 1 April 2023, the headline (ie, main) corporation tax rate will be increased to 25% applying to profits over £250,000.
- A small profits rate (SPR) will also be introduced for companies with profits of £50,000 or less so that they will continue to pay corporation tax at 19%. Companies with profits between £50,000 and £250,000 will pay tax at the main rate reduced by a marginal relief providing a gradual increase in the effective corporation tax rate.

APPENDIX B

ANNUAL ALLOWANCE AND MONEY PURCHASE ANNUAL ALLOWANCE

Annual allowance

The limit on individual tax relievable contributions to a pension in any tax year is the greatest of 100% of UK relevant earnings, or £3,600 (gross); employers have no limits on contributions (as long as they are wholly and exclusively made for business purposes). However, there's a further factor we need to consider: the annual allowance (AA).

The AA has been reduced considerably over the last few years – in 2010/11 it was £255,000, reduced to £50,000 in 2011/12 and to £40,000 in 2014/15. The standard AA is currently £40,000.

How the AA works

If the total of tax privileged savings in any pension input period (covered below) is above the AA, the amount over the AA is subject to a free-standing tax charge. This tax charge is called the annual allowance charge and is levied at the appropriate marginal rate ie, 20%, 40% or 45% (or their Scottish equivalents).

It has the effect of negating any tax relief received but can also apply where the member has not received any tax relief eg, if the excess was from the increase in benefits in a non-contributory defined benefit scheme, or from an employer's money purchase contribution. On the following events, contributions are excluded from the total pension input within the PIP that they occur (and as such are not counted against the AA). These are where the member:

- dies;
- becomes entitled to a serious ill health lump sum (life expectancy less than one year); and
- becomes entitled to all their benefits as they are unlikely to be able to work again, up until state pension age).

Defined contribution (DC) schemes

Under DC, the contributions being paid towards a pension arrangement are defined and measurable. So it's relatively easy to establish how much is being paid to a member's pension in any pension input period, being the sum of all contributions made by and on behalf of the member plus any employer contributions.

Defined benefit (DB) schemes

Contributions to a DB scheme are irrelevant for annual allowance. Instead, it is the growth in an individual's benefit which dictates whether the AA is exceeded. Special rules have been put in place for the calculation of DB schemes as a result of the summer 2015 budget changes. In a normal year, (ie, not 2015/16) within a DB scheme, we must work out the increase in benefits over the input. Calculating this increase in benefits involves calculating the opening value at the start of the pension input period and comparing it with the closing value at end of the pension input period (having considered inflation on the starting figure). The difference is the pension input amount, and this is then multiplied by 16 and, if relevant, cash in addition is added on. This figure is then assessed against the AA.

Example: At the start of the input period Clare has been a member of a 1/60th DB scheme for 19 years on a pensionable salary of £60,000. At the end of the input period her salary has increased to £66,000. Inflation (CPI) is assumed to be 2.5%.

Opening value:
(19/60 x £60,000 = £19,000) x 16 = £304,000.

This is revalued by CPI:
£304,000 plus 2.5% = £311,600.

Closing value:
(20/60 x £66,000 = £22,000) x 16 = £352,000.

Therefore, the pension input amount is
£352,000 – £311,600 = £40,400

Paying the annual allowance charge

The AA charge is charged to the individual and due under self assessment on 31 January following the end of the tax year. However, since the 2011/12 tax year, it has been possible to have the charge paid from the pension fund/benefits, rather than the pension holder's own funds (commonly known as scheme pays). Schemes can only be forced to pay the charge (known as mandatory scheme pays) where all of the following applies.

- The charge is more than £2,000.
- The pension input amount in that scheme exceeds the annual allowance.
- The member gives notice to the scheme to do so, within the correct timescale.
- The pension benefits must be reduced to reflect the charge being paid.

Mandatory scheme pays rules are slightly different where the MPAA or TAA are exceeded. Schemes can also pay on a voluntary basis if they wish.

At the time of writing, different timescales for scheme pays are being proposed to allow for later elections where new information amends the annual allowance amounts from 2016/17 onwards. This was required as a result of the McCloud judgment that affected public sector pension schemes, but the new rules will apply to all schemes.

For full details on all of the above subjects please see Annual allowance: scheme pays

APPENDIX C

There are many schemes with many different rules on what benefits can be paid and to whom. For example, some schemes will exercise discretion as regards who receives funds, some will not. Some schemes may be bound to pay a certain type of benefit, but not who they will pay it to.

One of the most common structures would be a wide class of beneficiaries where the scheme has absolute discretion on what type of benefit they will pay and to whom. The flowchart below outlines who may be paid and what under this structure.

TIP

Keeping copies of nominations with the will may remind people not to overlook their pension nominations when they are also changing their will. It is best practice to review nominations annually as part of the annual review of the clients' circumstances.

HAS A NOMINATION (EXPRESSION OF WISH) BEEN MADE BY THE MEMBER?

NO

Are there any dependants? Examples below.

- Married or with a civil partner.
- Children under age 23.
- Children physically or mentally impaired.

NO

Trustees would pay nominee benefits to person(s) they deem appropriate. Both lump sum and income benefits can be paid and would normally be free of IHT.

YES

Do the trustees believe payment to dependant is appropriate?

NO

In the event that the trustees deem payment to dependants is inappropriate (such as an estranged spouse) they can elect to pay 'nominee' benefits to another party. However, only lump sum payment is available. Benefits would normally be free of IHT.

YES

Trustees would pay 'dependant' death benefits to dependants. Both lump sum and income benefits can be paid. Benefits would normally be free of IHT.

YES

Was the nomination (express of wish) for a dependant?

NO

Although the trustees retain discretion to whom death benefits will ultimately be paid, they will usually follow the member's nomination. Both lump sum and income benefits can be paid to any dependant or the nominated person(s) only. Any other person could only receive a lump sum. Benefits will usually be free of IHT.

YES

Although the trustees retain discretion to whom death benefits will ultimately be paid, they will usually follow the member's nomination. Both lump sum and income benefits can be paid to any dependant.

Nominees could only receive a lump sum. Benefits will usually be free of IHT.

ONGOING DEATH BENEFITS

On the subsequent death of the dependant or nominee, any subsequent death benefits would be paid to a successor at the discretion of the trustees (after reference to any nomination/expression of wish made by the dependant/nominee). On the subsequent death of the successor, any subsequent death benefits would be paid to the next successor, again at the discretion of the trustees. Similar distribution rules apply: only nominated individuals can receive an income death benefit and a scheme administrator may only nominate an individual where the previous beneficiary has made no nomination.

APPENDIX D

ADVICE REQUIREMENTS FOR PENSION TRANSFERS

Pension transfers/conversions

The decision to move one pension arrangement to another can have a dramatic impact on consumer outcomes and as such is a decision that should not be taken lightly. The additional choices provided by the Pension Freedoms and Choice legislation resulted in the Department for Work & Pensions (DWP) and the Financial Conduct Authority (FCA) reassessing the level of protection and support provided to consumers facing the transfer dilemma.

So the first question should be 'what is a pension transfer or conversion?' The FCA definition of a pension transfer is the movement of safeguarded benefits to flexible benefits in a different scheme, as well as certain transfers of safeguarded benefits to other safeguarded benefits (such as transfers from safeguarded benefits in occupational schemes to safeguarded benefits in nonoccupational schemes).

A pension conversion is defined as a transaction resulting from a decision of a retail client to require the trustees or managers of a pension scheme to:

- convert safeguarded benefits into different benefits that are flexible benefits under that pension scheme; or
- pay an uncrystallised funds pension lump sum in respect of any of the safeguarded benefits.

Pension transfers permission required to conduct transfer/pension conversion business

Driven by amendments to the Regulated Activities Order (effective from 6 April 2015), firms are required to have pension transfer permissions to be able to transact any pension transfers or pension conversions, even where a firm is not providing the services of a Pension Transfer Specialist (PTS). Firms can apply for limited pension transfer activity permission if full permission is not required (eg, a firm may wish to conduct the transfer of certain safeguarded benefits with, say, minimum income guarantees as detailed below, but not the transfer of defined benefit schemes).

Guaranteed annuity rates (GAR)

There is one significant exception to the above permissions, which is where the advice is on conversions or transfers in respect of pension policies with a guaranteed annuity rate (GAR), this also includes the income guarantee on some retirement annuity contracts. Although these are safeguarded benefits, the FCA has decided not to require these cases to be checked by a PTS and as such advice can be provided by an adviser with the investment advice permission. The firm must, however, have transfer advice permissions. This is because an adviser with the investment advice permission, but not the pension transfer and opt out permission, must still prominently highlight the value of the GAR to their client. The adviser should do this as part of the suitability assessment report for their client.

Department for Work & Pensions

With effect from 6 April 2015 the DWP requires trustees or managers of a ceding pension scheme to receive written confirmation that a client, proposing the transfer or conversion of a pension with safeguarded benefits, has received appropriate advice, where they wish to flexibly access their benefits. This is a legal requirement which cannot be overruled. The customer does not have to take the adviser's advice and the ceding scheme should not enquire into the substance of any advice but the ceding scheme needs to ensure the adviser has given it.

The scheme must receive specific information before it can transfer.

- That advice provided is specific to the type of transaction proposed by the member.
- That the adviser has the required authorisations under the relevant legislation to provide advice on the transfer of safeguarded benefits ie, Article 53E of the Regulated Activities Order.
- The reference number of the company or business in which the adviser works.
- The name of the member that was given advice and the scheme in which they hold safeguarded benefits to which the advice applies.

These new regulations only relate to cases where the value of the safeguarded benefits is greater than £30,000. For the avoidance of doubt, although the DWP states that under £30,000 a ceding scheme does not have to ensure that a member has received advice, the FCA has no such ruling. Where an adviser is involved with the transfer or conversion of a pension they need to be appropriately authorised and qualified, irrespective of the value of the pension.

Financial Conduct Authority

The focus of the FCA's requirements is to ensure that individuals switching, converting or transferring their pension arrangements receive the appropriate level of advice, provided by advisers who have sufficient knowledge to ensure the client understands the implications of the proposed action, especially when the transaction is potentially sacrificing valuable safeguarded benefits. It is important to note that the FCA does not have an exemption for cases under £30,000 and while it acknowledges that the DWP does not require advice for a transfer under this value, it states that where advice is provided, it needs to be provided by an appropriately authorised and qualified adviser.

A transfer from an occupational scheme without safeguarded benefits ceased to be a transfer on 1 October 2020, so no transfer permissions are needed.

Opt-out permissions are not needed where there would be no redirection of contributions to a FCA-regulated replacement scheme, for example, because of LTA issues.

Permissions are not needed when advising a client on whether to join a DB scheme.

The treatment of pensions and divorce

Permissions are not required as the pension credit is not regarded as safeguarded benefits (or money purchase or cash balance benefits) or a transfer payment, but as a right in itself.

If an adviser advises an ex-spouse on using the pension credit to acquire rights in a DB scheme, this falls outside FCA regulation. Clearly if selecting a DC scheme the adviser must have investment advice permission.

While both opt outs and divorce cases do not require special permissions, they do involve forgoing the option of safeguarded benefits. As such, some advisers may well apply, or their compliance departments insist, on the same rigour and checking as they do to full pension transfer advice.

Safeguarded benefits

The term safeguarded benefits is referred to within both pension transfer and pension conversion. So what are safeguarded benefits? In the Pensions Schemes Act, safeguarded benefits means benefits other than money purchase benefits and cash balance benefits 'Section 48(7) of the Pension Schemes Act 2015'.

Therefore, if the only exclusions from the definition of safeguarded benefits are the above definitions, any other type of benefit will be regarded as safeguarded benefits. This includes the following.

- Defined benefit schemes.
- Any guaranteed annuity rate (GAR) – see section below.
- Any deferred annuity.

In January 2016 the DWP issued a factsheet on Pension benefits with a guarantee and the advice required in which it sought to further clarify the issue of safeguarded benefits. In the factsheet it stated that safeguarded benefits are defined in legislation as pension benefits which are not money purchase or cash balance benefits. In practice, safeguarded benefits are any benefits which include some form of guarantee or promise during the accumulation phase about the rate of secure pension income that the member (or their survivors) will receive or will have an option to receive. These include:

1. Under an occupational pension scheme, a promised level of income calculated by reference to the member's pensionable salary in the employment of the pension scheme's sponsoring employer (for instance, under a final salary scheme);
2. A promised level of income (or guaranteed minimum level of income) calculated by reference to the contributions or premiums paid by or in respect of the member (for instance, under some older personal pension policies); and
3. A promised minimum rate at which the member will have the option to convert their accumulated pot or fund into an income at a future point, usually on the member reaching a particular age (generally known as a guaranteed annuity rate, or guaranteed annuity option).

ADVISING ON NON-GAR SAFEGUARDED BENEFITS

Such is the potential for financial harm with the large sums that can be involved in pension transfers, there has rightly been a lot of regulatory focus on this. The most high-profile cases are those that were advised to transfer from the British Steel Pension Scheme.

The FCA remains of the view that, for most people, a transfer out of a DB scheme is unlikely to be suitable. However, the number of consumers receiving a recommendation to leave their DB scheme has been consistently too high.

Therefore, the FCA undertook various investigations and interventions in the advice space where safeguarded benefits were being given up. We now appear to be in a static place with the information in Policy Statement PS20/6 Pension transfer advice: feedback on CP19/25 and our final rules and guidance and Finalised guidance FG21/3 Advising on pension transfers. But perhaps there is a lot of information there that is not needed for the layperson. Perhaps an easier read for what good looks like would be to take the opposite view in what is in the FCA's advice checker.

The key call-outs from the advice checker are:

- Did the adviser obtain all of the relevant facts about their client?
- Things such as their whole family situation, what they need in retirement, what other pensions they and their partner have, their state of health.
- Did the adviser adequately check their client's understanding of pensions, the risks and benefits so that the client could adequately understand the risk they are taking on?
- Did the adviser recommend the client transfers their only or largest guaranteed pot?
- Is the client now in an investment with high charges and/or are they invested in unusual investments such as student accommodation, storage pods, parking schemes etc?
- Did the adviser recommend, in writing, that the client should not transfer but: hinted they should do so anyway, did not explain the value of their existing DB scheme, did not explain the risks of a transfer, gave the client a list of the risks of proceeding with a transfer against advice without making these personal to them?

So if an adviser is doing the converse to the above, this doesn't remove the potential for unsuitable advice, but should greatly lessen this, especially if the client is in a fully informed position about the risks of the transfer. The key risk is that, with the DB scheme, there is no risk borne by the member, even if the employer fails there is the 'lifeboat' of the pension protection fund that for most would protect 90% of their defined benefits. Whereas by transferring to the defined contribution world the risks are then totally borne by the member.

KEY POINTS BELOW

Ban on contingent charging

From 1 October 2020, contingent charging for pension transfers and conversions was banned. Contingent charging is where the adviser would only receive a fee if a transfer proceeded. It was this potential bias that was addressed as the values of DB transfers can be considerably high, and as such create a potential conflict of interest.

Firms must charge at least as much in relation to pension transfer advice as if they were offering investment advice on funds of the same value. This is to prevent firms from gaming the ban by charging a token fee for initial advice. Advice on pension transfers and conversions is generally more complex than other investment advice, and so should typically cost the same or more than other investment advice.

There are, however, two significant carve-outs that are exempt from the contingent charging ban: a serious financial difficulty carve-out; and a serious ill-health carve-out. For both carve-outs, firms need to show that the client is unable to pay for full transfer advice.

To assess ability to pay for full advice, firms should review copies of statements from all of the client's material accounts and investments. The FCA considers consumers who are claiming certain benefits are more likely to have no capacity to pay for advice. These include Universal Credit, Job Seekers Allowance, Employment Support Allowance, Income Support, Housing Benefit and Pension Credit.

Where relevant, consumers should be able to prove they are receiving benefits. The carve-out cannot be used if a client has available funds to pay for the advice but would prefer not to use their savings/income for this purpose. For these purposes, the availability of credit does not count as available funds.

Triage services

Before a client even enters the advice process, firms can offer a triage service for clients to decide if this is an option they want to pursue. Triage needs to be balanced, factual, unbiased and non-personalised. Care needs to be taken in any discussions with clients around DB transfers, that these do not stray across the advice boundary.

This may be particularly relevant if potential clients give their adviser information that suggests they might meet the test for the carve-outs. Advisers are not prevented from finding out more about their circumstances for the purpose of the carve-out, but thEy should take care not to imply their suitability for a transfer.

Good triage should cover the working of DB and DC schemes and cover:

- the pros and cons of each type of scheme;
- a summary of the sorts of consumers who might typically benefit or not benefit from a transfer but wIthout personalised references to the consumer's own circumstances; and
- information about the FCA view that most consumers are best advised to stay in a DB scheme, and that the FCA expects you to start advising from a position that a transfer will not be suitable.

Circumstances when you will decline to do business are:

- the difference between abridged advice and full advice; and
- the initial and ongoing costs involved.

Abridged advice

As of 1 October 2020, abridged advice can be given, this is a short form of regulated advice that can be given for pension transfers and conversions that require a Pension Transfer Specialist (PTS (an individual who has passed the required examinations on pension transfers and is employed by a firm to give advice on pension transfers, pension conversions and pension opt-outs or to check such advice in accordance with the regulatory rules)). It is perhaps best seen as a 'halfway house' between triage and full advice that can help identify the clients that may want to proceed after triage, but might not be suitable for a transfer. As this is a shortened form of regulated advice then the cost to clients should be much lower compared to receiving full advice not to transfer.

There are only two possible outcomes that can be given under the abridged advice route:

1. provide the consumer with a personal recommendation not to transfer or convert their pension; or
2. tell the consumer that it is unclear whether they would benefit from a pension transfer or conversion based on the information collected through the abridged advice process. The adviser must then check if the consumer wants to continue to full advice, and if they understand the associated costs.

Abridged advice will only cover the initial stages of the full advice process, including a full fact-find and risk assessment. Firms must not undertake APTA, provide a TVC (both of these are covered later as they are solely for the full advice process) or consider the consumer's proposed receiving scheme. If firms undertook these processes as part of abridged advice, they would effectively be giving full advice. As abridged advice does not consider how funds might be invested if a transfer proceeded, firms must not assess the risks associated with a specific flexible arrangement.

Firms do not need to offer abridged advice but, when they do, it must be carried out (or checked) by a PTS and the firms must provide a suitability report for advice not to transfer.

If a consumer chooses to continue to the full advice process, advisers/firms will need to offset the abridged advice charge from the full advice charge (unless a client uses different advisers for abridged advice and full advice).

Pension transfer specialist (PTS)

Currently a pension transfer specialist must have CF30 (customer function) and hold a qualification from either:

- G60 or AF3 (CII)
- Pensions paper of Professional Investment Certificate (IFS)
- Fellow/Associate of Pensions Management Institute
- Fellow/Associate of Faculty of Actuaries.

From October 2021, the FCA will require PTSs also hold the level 4 RDR qualification for advising on investments (or equivalent by other existing qualifications and gap-fill exercises) before they can advise on or check pension transfer advice.

Full details of the qualifications accepted are available in the FCA Training and Competence Handbook. The FCA heavily discourages direct offer or execution only in pension transfers and, if this is to take place, then the firm must make, and retain indefinitely, a clear record that no advice was given.

The FCA Handbook text reflects that a PTS is expected to:

- check the entirety of the advice process, not just the numerical analysis, and consider whether the advice is sufficiently complete;
- confirm that the personal recommendation is suitable;
- inform the firm in writing that they agree with the advice, including any recommendations, before the report is given to the client; and
- for any two-adviser models, ensure that any disagreements between the PTS and the adviser must be settled before the client is given the suitability report.

Continuing Professional Development (CPD) requirements

As of 1 October 2020, a PTS must undertake 15 hours of CPD (this is in addition to any other continuing professional development that is required, such as the 35 hours for a retail investment adviser). This must include nine hours of structured CPD and at least five hours of this structured CPD must be provided by an external independent provider.

Workplace Pension Schemes

Another concern of the FCA further to its suitability investigations were the robustness of the adviser's discounting of a WPS as a suitable option to transfer into.

The FCA considers the current (or morerecent) **Workplace Pension Scheme (WPS) as a destination for the transfer as the default fund (if available) should be appropriate for all members without the need for ongoing advice.** Workplace pensions meet the auto-enrolment criteria and must meet thresholds on maximum charges, and have independent governance on the funds offered, which included the defaults investment fund offered.

If the WPS is not being recommended it must be detailed why any other scheme is more suitable than (not simply as suitable as) the WPS.

If the most recent WPS does not accept additional contributions/transfers or may not be suitable, if a client wants to take drawdown immediately from the transfer then the most recent workplace pension that would meet these requirements should be considered.

The FCA feels that many consumers would not benefit from ongoing advice as their circumstances are unlikely to change significantly from year to year. These consumers will be more suited to the default WPS fund. Where ongoing advice is needed, the WPS does not offer this and it would add value for the consumer, the FCA expects firms to consider this as part of the recommendation, including the option of paying ongoing adviser charges directly rather than via the scheme.

Appropriate Pension Transfer Analysis (APTA) including the Transfer Value Comparator

APTA

From 1 October 2018, the Transfer Value Analysis System (TVAS) was replaced with the Appropriate Pension Transfer Analysis (APTA).

One of the stated aims of the APTA is to help 'prove' suitability. It removes the, often confusing, TVAS analysis and replaces this with an APTA which would set out the minimum level of analysis expected for income and death benefits. APTA should detail any 'trade-offs' that have to be made for objectives against needs. Part of this process is the inclusion of a prescribed comparator (TVC – see later) providing a financial indication of the value of benefits being given up.

As advisers are best placed to assess the needs and circumstances of their individual clients, the FCA has not prescribed what should and shouldn't be within an APTA, other than the new TVC which is prescribed.

In terms of contents this can include:

- both behavioural and non-financial analysis, as well as considering alternative ways of achieving client objectives;
- use of modelling tools, however, advisers should consider the part these tools play in explaining the options to individual clients;
- death benefit comparison; and
- overseas transfer comparisons.

The APTA can also be used for self-investing clients, although this does not reduce the need for the PTS to fully inform the client on their intended investment choices.

These other considerations also need to be factored in.

- Advisers must consider the impact of tax and access to state benefits, particularly where there would be a financial impact from crossing a tax threshold/band.
- The APTA must consider a reasonable period beyond average life expectancy, particularly where a longer period would better demonstrate the risk of the funds running out.
- Advisers must consider trade-offs more broadly and not just income v death benefits.
- Consider the safety nets – the PPF and Financial Services Compensation Scheme (FSCS) in the UK – that cover both the current and receiving schemes in a balanced and objective way.
- If information is provided on scheme funding or employer covenants, it should be balanced and objective.

The Transfer Value Comparator (TVC)

Previously the required analysis for DB transfers was the 'critical yield' which was very complex and difficult for clients to understand, this was therefore replaced with the TVC. Broadly, it was the investment return after charges which was required in the personal pension to allow the member to take benefits of the same level as they could have got in their DB scheme from their personal pension.

The TVC is part of the APTA, there is a mandatory TVC. It is worth noting that the rate of return is not based on the client's likely investment performance. Instead, this is based on a 'risk free' return from gilts to match the 'risk free' nature of the DB income being given up. Firms must follow the assumptions that are laid out in COBS19 Annex 4 so that the analysis cannot be gamed.

The TVC is purely a numerical analysis (following the prescribed methodology) that is displayed in graphical form to make it easier for the consumer to understand.

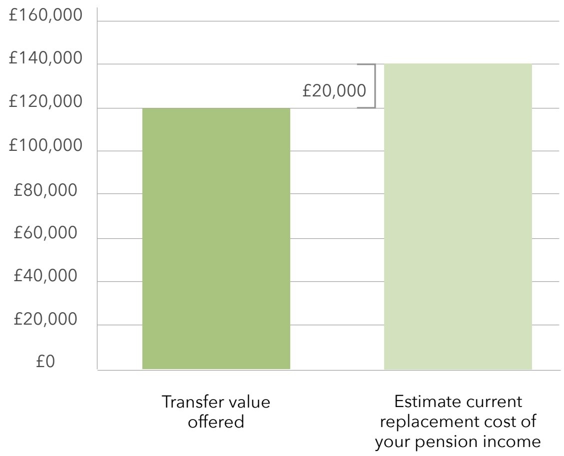
It must be displayed in the following format:

Will I be better or worse off by transferring?

- We are required by the Financial Conduct Authority to provide an indication of what it might cost to replace your scheme benefits.
- We have done this by looking at the amount you might need to buy the same benefits from an insurer.

It could cost you £140,000 to obtain a comparable level of income from an insurer.

This means the same retirement income could cost you £20,000 more by transferring.



This means advisers no longer have to explain a critical yield from a TVAS, instead they must fully inform the client of:

- the difference between the CETV value and the TVC value;
- the present discounted value of future cash flows; and
- the expected growth rate being on a ' risk free' basis (as it may be unlikely that a client would invest in gilts over the medium to long term).

TVC is only one element of the APTA to put the client in a suitably informed position. Its primary purpose is to help the customer understand the value of the guaranteed income stream and prevent 'hyperbolic discounting'. Hyperbolic discounting is where there is a clear mental preference for the value that you can get sooner rather than later, even where the present value is smaller than the future value. Given the large CETVs that are sometimes on offer there can be a preference to take the money on offer now, rather than wait and see the potential greater benefits in the future.

APPENDIX E

LIFETIME ALLOWANCE

There is no limit on the benefits an individual can receive or crystallise from registered pension schemes. However, there is a tax charge if the total value of benefits, at the point of a benefit crystallisation event (BCE), exceeds an individual's lifetime allowance (LTA).

The LTA that applies to an individual is usually the standard lifetime allowance for the tax year when the benefits are crystallised. However, there are circumstances where an individual LTA may be different from the standard figure, such as in the case of LTA protection. The standard LTA was introduced in 2006/07 and was set at £1.5m, this increased yearly until it reached £1.8m in 2010/11. However, the government decided to reduce the LTA to £1.5m from April 2012 and £1.25m from 6 April 2014 and then to £1m in 2016/17 and 2017/18. It increased by CPI from 2018/19 until 2020/21 up to £1,073,100 and will remain frozen at this level until 5 April 2026.

As each BCE occurs, it is tested against the LTA and uses up a percentage of the LTA, reducing the remaining LTA available for future BCEs. There are 13 BCEs that require benefits to be tested against the LTA. These are the main ones used and the valuation factors:

Benefit Crystallisation Event	LTA valuation
BCE1: member moves into a drawdown pension	Value of fund designated for drawdown payments
BCE2: member takes a scheme pension	
BCE4: member uses pension funds to buy an annuity	
BCE5 a and b: member reaches age 75	
	DC: Value of fund
	DB: 20 x pension plus any cash by addition
BCE5 c and d: pension death benefits paid from uncrystallised funds	Value of fund designated to drawdown or used for annuity purchase
BCE6: member becomes entitled to a lump sum eg, UFPLS or PCLS	Amount of lump sum paid
BCE7: lump sum death benefits are paid	Amount of lump sum paid

NB: Taking benefits usually involve two BCEs – one for the tax-free cash payment and one for the attached pension provision.

Pre-commencement pension benefits

If a pension, annuity or income drawdown was already in payment at A-day (5 April 2006), this is referred to as a pre-commencement pension. As these benefits were in payment before the introduction of the LTA, they aren't directly tested against the LTA. However, as the LTA takes into account all benefits paid at the first BCE after A-day, pre-commencement pensions are taken into account to calculate how much LTA is still available. The valuation factor for pre-commencement pensions is 25 times (not 20) as any lump sum previously paid is not directly taken into account.

What type of income figure to be used will vary depending on the source.

- Annuities and scheme pensions in payment – the yearly rate of pension payable at the time of the first BCE.
- For drawdown contracts – it would normally be the maximum income that could be taken at the time of the first BCE after 5 April 2006. However, the series of drawdown changes we have seen has slightly complicated matters. Where the BCE happened when MAX GAD was 100% or 120% then it is the maximum drawdown amount.
- For a pre-commencement pension in capped drawdown, where the first BCE occurs after 5 April 2015. The amount maximum GAD needs to be multiplied by is 80% to reduce the new maximum GAD of 150% back down to the 120% GAD figure (120/150 = 0.80).
- Where the BCE happens after the capped drawdown was converted to either flexible or flexi access drawdown, the amount used was what the maximum income would have been (with the 80% adjustment as necessary) in the year the capped plan was converted.

Lifetime allowance charge

The lifetime allowance charge is levied on the value of the pension benefits that exceed the pension holder's available LTA at a BCE at the following rates.

- 55% if the excess is paid as a cash lump sum to the individual, effectively taking the money out of the pension's regime.
- 25% if the excess is retained in the pensions regime to provide a pension income (the subsequent income may also be liable to income tax) or if the money is transferred offshore to a Qualifying Registered Overseas Pension Scheme (QROPS).

Checking benefits are within the LTA

The scheme administrator is jointly responsible with the member for paying any LTA charge and therefore needs to identify whether any tax is due at the time benefits are claimed. The scheme can decide what information it requires in order to put benefits into payment.

Typically, a simple declaration that there is sufficient LTA will suffice but where benefits are higher, or protections exist, a provider may wish to see full details of all pension benefits taken before any payment is being made.

Entitlement to higher LTA

Although most people will have their pensions savings assessed against the standard LTA at the point of crystallisation, it's possible to have a LTA higher (or lower) than the standard LTA. There are two ways that we need to consider:

- where LTA protection applies; and
- where the individual is entitled to a higher LTA.

Individuals may be entitled to a higher LTA than standard, in certain circumstances. The main circumstances are:

- entitlement to a pension credit from a pension sharing order;
- for periods that they were not UK residents; or
- if they transferred in some overseas pension rights.

Types of LTA protection

Primary protection

- Available where benefits were valued over £1.5m on 5 April 2006.
- Contributions could still be paid, and active scheme membership maintained without losing protection.
- Provides an additional percentage of LTA at crystallisation eg, if benefits were £3m at 5 April 2006 there would be 100% extra standard LTA ie, an extra LTA is available.
- From April 2012 the factor is applied to the underpinned lifetime allowance – an LTA of £1.8m until the standard LTA increases above £1.8m again.
- Applications closed on 5 April 2009.

Enhanced protection

- Available at 5 April 2006 regardless of pension value.
- All future contributions to DC pensions had to stop, and future accruals in DB schemes became strictly limited.
- Effectively, it means that there's no LTA test at a BCE.
- Can be lost under certain circumstances eg, as making pensions contributions.
- Applications closed on 5 April 2009.

Fixed protection 2012

- Broadly like enhanced protection.
- Fixed LTA of £1.8m.
- Contributions to DC pensions had to stop before 6 April 2012, and accruals in DB schemes were also strictly limited (stricter than enhanced).
- You could only apply for fixed protection if you didn't already have primary or enhanced protection.
- Applications closed on 5 April 2012.

Fixed protection 2014 (FP14)

- Similar to fixed protection 2012 except that there was a fixed LTA of £1.5m.
- Applications closed on 5 April 2014.

Individual protection 2014 (IP14)

- Available for anyone without primary protection and with pension savings of more than £1.25m on 5 April 2014.
- People have a personalised LTA of the value of their pension savings on 5 April 2014, capped at £1.5m.
- Pension savings can continue – all growth will be subject to excess charges.
- Can be held concurrently with enhanced and fixed protections which take precedence.
- Applications closed on 5 April 2017.

Fixed protection 2016

- Similar to fixed protection 2014 except that a fixed LTA of £1.25m applies.
- No application deadline but contributions/active accrual had to cease on 5 April 2016.
- Online application process and no certificate issued.

Individual protection 2016

- Similar to individual protection 2014 except that it is for people who have pension savings of more than £1m on 5 April 2016.
- Personalised LTA of value of pension savings on 5 April 2016 capped at £1.25m.
- No application deadline.
- Online application process and no certificate issued.

APPENDIX F

NON-ADVISED DRAWDOWN INVESTMENT PATHWAYS

The introduction of pensions freedoms made more people aware of the potential benefits of passing on wealth down the generations. But the FCA also looked into those that were making decisions without advice and the potential outcomes that this would generate. It found non-advised customers were struggling to make investment decisions and that this led to many just 'defaulting' into cash.

The FCA deemed too many non-advised drawdown customers were investing mainly in cash funds without understanding how this affected their potential for fund growth. From 1 February 2021 firms must offer default investment pathways for consumers who enter drawdown without taking regulated advice.

Investment pathways will be based on certain criteria eg, within the next five years does the member plan to:

- leave their fund untouched?
- start taking a long-term regular income?
- use the fund to buy an annuity?
- take the full amount of pension fund?

Only one pathway can be offered per option for a client (although these can be tailored to client's age). For example, not all clients selecting option 1 may be offered the same fund(s) for that pathway, this could allow for target dated funds based on a client's age.

While there is an easement for smaller companies, larger companies must offer at least two of the four pathways to customers. Large companies will have to refer consumers to another provider's pathway solutions for any objectives for which they don't themselves provide a pathway solution.

The aim is that, after February 2021, a consumer can only invest mainly in cash if they take an active decision to do so.

Investment in cash risk warnings

Another step towards making cash an active investment decision is that providers had six months from the date FCA rules came into force to assess their clients and provide risk warnings where necessary.

Risk warnings must be provided to:

- non-advised consumers moving funds into drawdown or requesting a drawdown transfer; and
- non-advised consumers already in drawdown;

where more than 50% of the total drawdown pot is invested in cash (including cash-like assets).

TIP	Breaching the lifetime allowance is not necessarily a bad thing. Due to the value of some benefit types eg, defined benefit schemes, or employer matching of personal contributions, the net of LTA tax benefits may be better than those that could otherwise be accrued outside the pension system at the same cost. A full analysis of options available should always be undertaken before any decision to stop accruing benefits in a pension scheme. See full details at Pension facts and planning.

ISBN: 978-1-78363-663-1

Chartered accountants are talented, ethical and committed professionals. There are more than 1.8m chartered accountants and students in the world, and more than 187,800 of them are members and students of ICAEW. All of the top 100 global brands employ chartered accountants.*

Founded in 1880, ICAEW has a long history of serving the public interest and we continue to work with governments, regulators and business leaders globally. And, as a world-leading improvement regulator, we supervise and monitor over 12,000 firms, holding them, and all ICAEW members and students, to the highest standards of professional competency and conduct.

We promote inclusivity, diversity and fairness and we give talented professionals the skills and values they need to build resilient businesses, economies and societies, while ensuring our planet's resources are managed sustainably.

ICAEW is the first major professional body to be carbon neutral, demonstrating our commitment to tackle climate change and supporting UN Sustainable Development Goal 13.

We are proud to be a founding member of Chartered Accountants Worldwide, a network of 750,000 members across 190 countries which promotes the expertise and skills of chartered accountants around the world.

We believe that chartered accountancy can be a force for positive change. By sharing our insight, expertise and understanding we can help to create sustainable economies and a better future for all.

www.charteredaccountantsworldwide.com
www.globalaccountingalliance.com

ICAEW
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA UK

T +44 (0)1908 248 250
E generalenquiries@icaew.com
icaew.com/pfp

Chartered Accountants Worldwide
Member

GAA
Global Accounting Alliance

ICAEW is carbon neutral

* Source: CAW, 2020 – Interbrand, Best Global Brands 2019