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Paraplanners' retirement planning and pension toolkit

Next

FundsNetwork™

Supporting paraplanners in a world of constant change

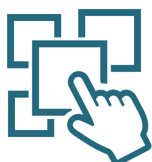
There has been a growing level of qualification and professionalism within advisory firms since the introduction of the RDR in 2012. Paraplanners have been at the heart of this development and, accordingly, FundsNetwork has always recognised their importance to the advisory market. They are the engines of the advisory practice, allowing advisers to do what they do best – see the clients and nurture those relationships.

The growth in the paraplanning role has come against a backdrop of incessant industry change from a regulatory, legislative and technical perspective. These developments will undoubtedly continue to present challenges throughout 2019. Therefore, to help you stay on top of all the technical and regulatory intricacies of pensions, retirement and tax planning, we've developed this interactive Paraplanner Toolkit. It allows you to easily dip in and out of topical and technical insights on a wide range of areas. It can also assist those studying for industry exams or who simply want to improve their pension knowledge.

I hope you find it an invaluable aid.

Paul Squirrell
National Pensions Sales Manager, FundsNetwork

What's covered in the toolkit



Technical matters

Helping you with your due diligence

Client-facing guides to aid your discussions

Other material to help you

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Technical matters

1. The State Pension – the old versus the new

The State Pension is an important consideration when managing a client's overall income in retirement. However, entitlement and the amount due will depend on a number of client-specific factors. What's more, the State Pension changed on 6 April 2016 and different rules apply depending on when a person reaches State Pension age. Here we examine the differences between the old and new State Pensions and the options open to clients should they wish to boost their entitlement or defer their State Pension.

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Changes to the State Pension

The UK State Pension changed on 6 April 2016 for people who reached State Pension age on or after that date. This means that men born on or after 6 April 1951 and women born on or after 6 April 1953 now qualify for the new State Pension (assuming they have built up an entitlement). Anyone who reached State Pension age before 6 April 2016 falls under the old system.

How the State Pension age will rise in the future

As life expectancy has continued to increase, the government has been reviewing the age at which the State Pension is paid to men and women. As such, the State Pension age for women has been rising to 65 since 2010 and this process will be complete by November 2018. It is then rising for both men and women as follows:

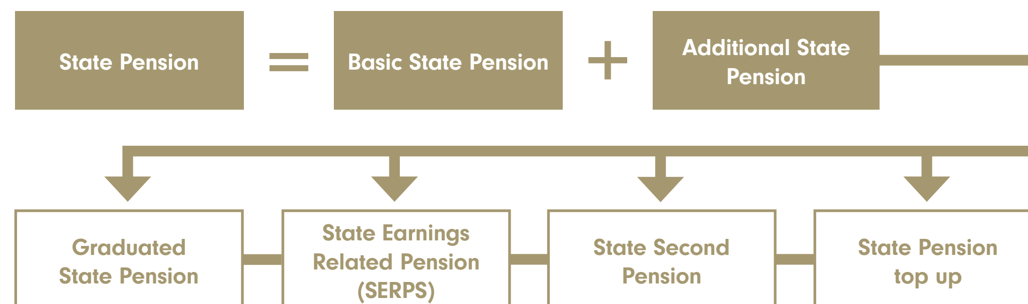
- Rising to age 66 between December 2018 and October 2020
- Rising to age 67 between 2026 and 2028
- Rising to age 68 between 2044 and 2046. The government has announced plans to bring this timetable forward which will see the increase to 68 happen between 2037 and 2039

There are plans to change State Pension ages further.

You can check someone's State Pension age at www.gov.uk/state-pension-age

The State Pension landscape

Old State Pension (pre-6 April 2016)



New State Pension (post-6 April 2016)

The old State Pension (including the basic and Additional State Pension)

Anyone who reached the State Pension age before 6 April 2016 is entitled to the basic State Pension, subject to having an adequate National Insurance contributions (NIC) record. This covers men born before 6 April 1951 and women born before 6 April 1953. Once a person reaches State Pension age, they have to make a claim in order to receive the basic State Pension – it is not paid automatically.

For the 2018/19 tax year, the maximum weekly payment is £125.90. The annual increase is underpinned by the government's 'triple lock' commitment (introduced in April 2011). This guarantees to increase the State Pension each year by a minimum of either:

- 2.5%
- The rate of inflation (CPI)
- The rate of average earnings growth

Eligibility

Since April 2010, a person will need to have built up 30 qualifying years of NICs in order to be entitled to the full basic State Pension. If they have fewer than 30 qualifying years their basic State Pension will be less.

Prior to the 2010/11 tax year, an individual would need to have been credited with NI contributions across at least 25% of the qualifying period in order to be eligible for any State Pension at all. Since the 2010/11 tax year, someone only needs to have been credited with qualifying NI contributions for one year.

A person may have earnt qualifying years through:

- Working and paying National Insurance (NI is payable by employed and self-employed individuals alike, albeit at slightly different rates)
- Receiving NI Credits (received because they were, for example, unemployed, unwell or a parent or carer)
- Making voluntary NI contributions (this option is still available for people who have already passed State Pension age and who wish to increase their payments – please see page 14)

Claiming a State Pension on the basis of someone else's NIC record

Where a spouse or civil partner has not paid or been credited with enough NICs to qualify for at least 60% of the basic State Pension in their own right, they may be able to claim a category B pension based on the NIC record of their spouse or civil partner. To be able to claim, their spouse or civil partner, including where deceased, must have reached State Pension age before 6 April 2016.

The old State Pension rules will still apply to people who reached State Pension age before 5 April 2016, but they will only be able to use the NI contributions their spouse or civil partner made for tax years up to and including 2015/2016 to improve their basic State Pension entitlement.

An individual will only be able to use their ex-spouse or civil partner's NIC record to increase the level of their basic State Pension provided they have not remarried or formed a new civil partnership before they reached State Pension age.

Depending on the contributions their spouse or civil partner has made, they could receive a category C or D basic State Pension of up to £75.50 per week in the 2018/19 tax year, including any basic State Pension of their own.

If a spouse/civil partner reached State Pension age on or after 6 April 2016, their State Pension will normally be based exclusively on their own NIC record. Spouses/civil partners may also benefit from a deferred pension (please see page 16).

Supplementary earnings-related pension payments

Recipients of a basic State Pension may also qualify for supplementary pension payments through the Graduated Retirement Benefit scheme or the Additional State Pension.

Entitlement to these could be built up by someone who was employed (but not self-employed) and was based on their earnings and Class 1 NIC history. The rules relating to entitlement under each scheme changed several times over the years.

The old State Pension (including the basic and Additional State Pension) continued

Graduated Retirement Benefit

This was the earliest form of earnings-related pension which preceded the State Earnings Related Pension Scheme (SERPS) and the Second State Pension (S2P). It was intended to top-up the basic State Pension, although it is independent of a basic pension entitlement. It operated between 1961 and 1975 and any payment to an individual is based on graduated contributions made on earnings over the period the scheme operated.

The Additional State Pension

The Additional State Pension can be made up of three separate schemes, which are listed below. These were in place at different times, and an individual may have contributed to more than one. Until 6 April 2016, it was possible to have been contracted out of all elements of the Additional State Pension:

1. State Earnings Related Pension Scheme (SERPS)	2. State Second Pension (S2P)	3. State Pension top up
A person may have built up entitlement to this scheme, which ran between 1978 and 2002, through being employed and paying Class 1 NICs.	Someone may have also built up entitlement to the State Second Pension (S2P) between 6 April 2002 and 5 April 2016 through: • Being employed and earning at least the lower earnings limit • Looking after children aged under 12 and claiming Child Benefit • Caring for a sick or disabled person for more than 20 hours a week and claiming Carer's Credit • Working as a registered foster carer and claiming Carer's Credit • Receiving certain other benefits as a result of illness or disability	This scheme allowed anyone who reached State Pension age before 6 April 2016 to top up their additional State Pension through payment of a one-off lump sum. The maximum extra pension someone could buy was £25 per week. The scheme operated until 5 April 2017.

Protection of benefits

If benefits have been built under these former schemes, they are protected both for those who have already retired and those who have not yet reached State Pension age. This means that anyone who reaches State Pension age after 6 April 2016 will receive the higher of the benefits when comparing the old and new schemes.

Contracting out

If, at any time, someone was 'contracted out' (typically through a workplace pension, though some stakeholder and personal pensions were also contracted out), no entitlement to the Additional State Pension would have built up over that period. Instead, members paid lower NICs or some of their NI was paid to their private pension scheme instead. As a result, they gave up some Additional State Pension in return for building up extra pension entitlement through their 'contracted out' pension arrangement. This amount is usually the same or more than the amount they would have been entitled to from the Additional State Pension had they not contracted out.

The amount of money someone would have built up in the state scheme, but which is now part of their work scheme, is shown on their pension statement (please page 14). This is known as their 'Contracted Out Pension Equivalent' or COPE.

Divorce

If someone gets divorced, or if their civil partnership is dissolved, the court may decide that any Additional State Pension should be shared as part of the settlement. The order will only be calculated in relation to any Additional State Pension or protected payments.

Inheritance

Please refer to page 22 for the rules on inheritance.

The new 'Single-Tier' State Pension

This scheme was introduced in April 2016, replacing the old system of basic and Additional State Pension, combining these into one payment. The government believed the old system was too complicated – it was difficult to work out how much you would be entitled to until you were close to retirement age. With the new State Pension, you will know from a much younger age how much you are likely to get. Contracting out of the Additional State Pension was also permitted under the old system adding further complication in calculating someone's entitlement from the state. Contracting out of the Additional State Pension ended on 5 April 2016.

An individual is able to claim the new State Pension if they reach State Pension age on or after 5 April 2016:

- Men born on are after 6 April 1951
- Women born on or after 6 April 1953

It is different to the basic State Pension in the following ways:

- The maximum payment is set at £164.35 per week in 2018/19
- 35 qualifying years are required in order to obtain the full amount
- 10 qualifying years are required in order to be entitled to any amount
- There is no option to contract out
- Someone can no longer claim based on their spouse's or civil partner's NI record (except those covered by transitional protection)

As with the basic State Pension, the new State Pension increases each year in line with the government's 'triple lock' commitment.

Eligibility

An individual can build up entitlement to the new State Pension through:

- Working and paying National Insurance (class 1 for employed individuals, class 2 and 4 for self-employed individuals)
- NI Credits (received because they are, for example, unemployed, unwell or a parent or carer)
- Voluntary NI contributions (these allow someone to make up any shortfall in their payments – this is still an option for clients who have already passed State Pension age and these payments are covered on page 14)
- A person may also qualify if they paid married women's or widow's reduced rate contributions

A person has to claim the new State Pension – it is not paid automatically.

How the new State Pension is calculated

An individual's National Insurance record prior to 6 April 2016 is used to calculate what is known as their 'starting rate'. This is the higher of either:

- The amount they would have received under the old basic State Pension (including any extra payments from the Additional State Pension)
- The amount they would get if the new State Pension had been in place at the start of their working life

The starting amount may have been adjusted downwards to take account of any period the person was contracted out of the Additional State Pension. It is possible to have a starting amount which is above the full new State Pension. The extra amount is known as an individual's 'protected payment' and will be paid on top of their new State Pension. If the starting amount is less than the full new State Pension, a person can add qualifying years through any of the ways listed above (this has been possible since 6 April 2016). Qualifying years can be added until they reach the full State Pension amount or State Pension age – whichever comes first.

Each qualifying year on an individual's NI record will add 1/35th of the full amount of the new State Pension to their starting amount.

The new 'Single-Tier' State Pension (continued)

The new State Pension – an example

As at 6 April 2016, Mr A had a starting amount of £110 per week. He has continued to make NI contributions since that date and has added two more qualifying years as at 5 April 2018. Each additional year entitles Mr A to an extra £4.70 per week (£164.35 divided by 35) based on 2018/19 figures. His current entitlement is therefore £119.40.

In order to be entitled to the full new State Pension (£164.35 as at 2018/19), Mr A will need a little over a further nine qualifying years.

Working past State Pension age

No one has to stop working any more once they reach State Pension age. However, they cannot accumulate further qualifying years by continuing to work. This is because they no longer pay National Insurance once they reach State Pension age.

National Insurance (NI) records and NI credits

As indicated above, a person will need to accumulate 35 qualifying years in order to be entitled to a full new State Pension.

A person will earn a qualifying year through working if they:

- Are employed and earn over the Primary Threshold (PT) from one employer (they may still earn a qualifying year if they earn between the Lower Earnings Limit (LEL) and the PT from one employer)
- They are self-employed with profits above the Small Profits Threshold (SPT) and make Class 2 NI contributions
- Are eligible to receive NI Credits. Examples include if they are looking for work, unable to work through ill health or disability, are on certain benefits, are looking after a child or are a carer. A full list can be found on the government's website: www.gov.uk/national-insurance-credits/eligibility
- Make voluntary NI contributions

Grandparents or other family members who care for a child under 12, usually while the parent or main carer is working, may also be entitled to 'specified adult childcare credits'. These also help to build up NI contributions.

National Insurance thresholds for 2018/19	
Lower Earnings Limit (LEL)	£116 per week / £6,032 per year
Primary Threshold (PT)	£162 per week / £8,424 per year
Small Profits Threshold (SPT)	£6,205 per year

Gaps in a NI record

An individual may have a gap in their NI record for a number or reasons. The most common ones are:

- Living abroad for a period of time
- Were employed but on low earnings (less than the LEL)
- Not working and not claiming any benefits
- Were self-employed but not paying NI contributions because their profits were below the Small Profits Threshold

A gap in an NI record does not necessarily mean the person will not receive a full new State Pension – as long as 35 qualifying years are accumulated by the time they reach State Pension age they will receive payment in full. However, if gaps in a record will prevent full payment, then the person could choose to make voluntary NICs to make up for these (please see page 14).

The new 'Single-Tier' State Pension (continued)

Claiming or receiving a State Pension on the basis of someone else's NIC record

Someone who reaches State Pension age on or after 6 April 2016 will receive the new State Pension based on their NI record only. There is one exception to this – where transitional protection was provided for married women or widows who previously opted to pay reduced rate NI contributions. This was known as Reduced Rate Election or 'the married women's stamp'.

Where these rules apply, the person does not need 10 qualifying years of their own to receive any State Pension. They will receive a State Pension that will be about the same as:

- The lower rate basic State Pension of £75.50 a week in 2018/19 rate (if married and their husband has reached State Pension age)
- The rate of the basic State Pension of £125.95 a week in 2018/19 rate (if widowed or divorced)

They will also receive any Additional State Pension that they built up before 6 April 2016 on top of this basic amount. To qualify, the Reduced Rate Election must have been in force at the start of the 35-year period ending on 5 April before the person reaches State Pension age.

Divorce

If someone gets divorced, or if their civil partnership is dissolved, the court may make a pension sharing order.

Inheritance

Please refer to page 22 for the rules on inheritance.

Impact on Guaranteed Minimum Pensions

As we described above, members of occupational pension schemes were able to contract out of the Additional State Pension under the old pension system. For individuals who were contracted out of defined benefit schemes between 1978 and 1997, the pension scheme had to provide a Guaranteed Minimum Pension (GMP) so that they are not worse off as a result of contracting out.

Under the old system GMPs had to be increased each year, a practice known as 'uprating'. Responsibility for this was borne by both the pension scheme and the government. In practice, pension scheme providers are required to uprate GMP rights in line with the legislative minimums:

- GMP accrued between 1988 and 1997: CPI subject to a 3% cap
- GMP accrued between 1978 and 1988: no requirement to uprate

Although these are the minimums, GMP amounts can be increased by more subject to scheme rules.

Scheme providers will continue to revalue GMPs based on earnings growth for people who remain in defined benefit schemes after 6 April 2016. If a member leaves a scheme after 6 April 2016 but before they reach the scheme's pensionable age, the scheme provider can choose to revalue the GMP by earnings growth or by a fixed rate.

Under the old system, the amount of State Pension paid each year was recalculated with the GMP deducted from the Additional State Pension the person would have earned had they remained contracted-in. The effect was to ensure the full GMP amount was uprated with the government sharing some of the costs for paying the annual inflation increases. The government paid any increases above those paid by the scheme by adding it to the individual's Additional State Pension.

Under the new system the government will no longer take account of the value of any GMP when it uprates the new State Pension each year. The government is not required to know the value of any individual's GMP in order to calculate their new State Pension entitlement as it will have already been factored into the starting amount. The scheme provider will therefore become solely responsible for maintaining member GMP records when the GMP data reconciliation period comes to an end in October 2018. This is different to the old system, where reconciliation took place at the point a person left the scheme, reached GMP age or reached State Pension age. In effect, this means that GMPs will not be fully uprated through the State Pension. However, individual schemes may decide to uprate GMP for those affected by this change.

The new 'Single-Tier' State Pension (continued)

The uprating of Guaranteed Minimum Pensions is a complicated area. The impact of this on people with GMPs will vary depending on a number of factors including their age, employment history, earnings and future inflation. Modelling by the National Audit Office shows that some people may actually be better off if they are able to build up additional qualifying years after 6 April 2016. However, people who spent long periods in contracted-out schemes and who retired – or plan to retire – shortly after 6 April 2016 are likely to be amongst the worst affected. This is because they have little time to build additional entitlement to the new State Pension. Those who have built up high amounts of pre-1988 GMP are also likely to be amongst the worst affected as scheme providers will only uprate post-1988 GMPs up to the 3% cap. If inflation is higher than 3% then both pre-1988 and post-1988 GMP holders could be worse off.

Guaranteed Minimum Pensions (GMP) uprating example

Scenario 1 – State Pension as at 4 April 2016 (old scheme)

Pension element	Starting amount	Increase by scheme		Increase by government		Total increase by end of year	
State Pension	**£7,000**	**–**	**–**	**5.00%**	**£340**	**4.86%**	**£340**
Basic State Pension	£6,500	–	–	5.00%	£325	5.00%	£325
Additional State Pension	£500	–	–	3.00%	£15	3.00%	£15
Scheme Pension	**£6,000**	**3.80%**	**£230**	**1.20%**	**£70**	**5.00%**	**£300**
Excluding GMP	£4,000	5.00%	£200	–	–	5.00%	£200
Pre-88 GMP	£1,000	–	–	5.00%	£50	5.00%	£50
Post-88 GMP	£1,000	3.00%	£30	2.00%	£20	5.00%	£50
Overall total	**£13,000**	**1.77%**	**£230**	**3.15%**	**£410**	**4.92%**	**£640**

Scenario 2 as at 6 April 2016 (new scheme)

Pension element	Starting amount	Increase by scheme		Increase by government		Total increase by end of year	
State Pension	**£7,000**	**–**	**–**	**5.00%**	**£340**	**4.86%**	**£340**
Basic State Pension	£6,500	–	–	5.00%	£325	5.00%	£325
Additional State Pension	£500	–	–	3.00%	£15	3.00%	£15
Scheme Pension	**£6,000**	**3.80%**	**£230**	**–**	**–**	**3.80%**	**£230**
Excluding GMP	£4,000	5.00%	£200	–	–	5.00%	£200
Pre-88 GMP	£1,000	–	–	–	–	–	–
Post-88 GMP	£1,000	3.00%	£30	–	–	3.00%	£30
Overall total	**£13,000**	**1.77%**	**£230**	**2.61%**	**£340**	**4.38%**	**£570**

For these scenarios, we've assumed that the earnings are at 5%, scheme pension at 5% and CPI at 3%.

Working and retiring overseas

Working abroad

A person's UK State Pension is based on their UK NI record and so a period working abroad will not generally count when calculating the State Pension they will receive. However, time spent abroad can in some cases be used to make up 10 qualifying years, the minimum required to qualify for the new State Pension. This should be possible if the individual has lived or worked in:

- The European Economic Area (EEA)
- Switzerland
- Gibraltar
- Certain countries which have a social security agreement with the UK

So, for example, if someone has worked in Switzerland for 20 years but for only five in the UK, they will meet the minimum 10 qualifying years requirement. However, their UK State Pension will only be based on their UK NICs – five years in this example.

It may be possible for someone to pay into and accrue benefits to a state pension in the country they are living in. Individuals should contact the pension department in the relevant country to check if they can pay into or receive another country's state pension.

Retiring abroad

People retiring abroad are able to claim their UK State Pension in most countries around the world. However, the State Pension will only increase each year if that person lives in one of the following places:

- The European Economic Area (EEA)
- Switzerland
- Gibraltar
- Certain countries which have a social security agreement with the UK

If someone lives in a country where their UK State Pension is not increased, it may be increased for the time they visit the UK (or other countries where the annual increase is paid). When they return to the country they normally live, their UK State Pension will return to its usual rate.

Claiming the State Pension

Depending on where someone has lived or worked, they may need to make more than one pension claim. If the claim relates to a state pension accumulated in the EEA, Gibraltar or Switzerland, they will only need to claim their state pension in the last country they lived or worked in. Their claim will cover all EEA countries (including the UK), Gibraltar and Switzerland. They don't need to claim for each country separately.

If they are living in a country outside the EEA, Gibraltar or Switzerland, they will need to claim for each pension separately.

Checking entitlement and making up for shortfalls

Individuals can get an estimate of their State Pension based on:

- Their current NI contribution record and
- The assumption they continue to make NICs up until they reach State Pension age

This service is available online (the individual needs to be registered for HMRC's online services): www.gov.uk/check-state-pension

A State Pension statement can also be obtained by completing and returning form BR19 which can be downloaded from: www.gov.uk/government/publications/application-for-a-state-pension-statement

Alternatively, anyone who lives in the UK can get a State Pension statement by calling 0345 3000 168. They can also apply for a National Insurance statement from HMRC to check if their record has any gaps at: www.tax.service.gov.uk/shortforms/form/NIStatement

Making up for shortfalls

A shortfall in someone's NI record may mean they will not qualify for a full State Pension (35 qualifying years are required in order to qualify for full payment). The most common reasons for a NI gap are:

- Living abroad for a period of time
- Employed but with earnings below the Lower Earnings Limit (£116 a week in 2018/19)
- Not working and not claiming any benefits
- They are self-employed and not paying NICs because their profits are below the Small Profits Threshold of £6,025

If this is the case – and the person is unable to make up for the gap by the time they reach State Pension age – they could consider making voluntary NICs. However, they must be eligible to make voluntary payments for the time the contributions cover (please see the table opposite).

Situation	Class to pay
Living abroad and working (but only if the person worked in the UK immediately before leaving and previously lived in the UK for three years in a row or paid three years' NI contributions)	Class 2
Living abroad and not working (but only if at some point the person lived in the UK for three years in a row or paid three years' NI contributions)	Class 3
Employed on low earnings (less than £116 a week in 2018/19) and not eligible for NI credits	Class 3
Self-employed with profits under £6,025 or self-employed as an examiner, minister of religion or in an investment or land and property business	Class 2 or 3 (they count towards different benefits)
Unemployed and not claiming benefits	Class 3
Married woman or widow who stopped paying reduced NI rates	Class 3
Someone who has reached State Pension age and wants to fill NI gaps	Class 3

It is only possible to fill gaps in tax years which are not already qualifying years. There are also time limits for paying. Individuals can usually only pay voluntary contributions to fill gaps in the previous six years. However, there are special arrangements for people who reached State Pension age on or after 6 April 2016. They have until 5 April 2023 to pay voluntary contributions to make up gaps between April 2006 and April 2016.

Voluntary contributions do not have any impact on the eligibility or amount of the Additional State Pension someone receives.

Checking entitlement and making up for shortfalls (continued)

Cost of voluntary contributions

The cost to fill in gaps in an NI record for the 2017/18 tax year are:

Type	Weekly amount	Annual equivalent
Class 2	£2.85	£148.20
Class 3	£14.25	£741.00

Each additional qualifying year equates to an extra £4.70 a week (or £244.40 a year) in State Pension based on 2018/19 rates. Men born after 5 April 1951 and woman born after 5 April 1953 pay different rates for voluntary contributions made by 5 April 2019 to make up for gaps between April 2006 and April 2016.

Deferring the State Pension

A person can also increase the starting level of their State Pension through deferment (this is not an option if they are on certain benefits). This is also an option for someone who is already claiming their State Pension, although this can only be done once (this is not normally possible if the person lives outside of the UK). The increase they gain from deferring depends on when they reach State Pension age:

Individuals who reached State Pension age before 6 April 2016

These people can choose to receive higher weekly payments or a one-off lump sum as a result of deferring their pension:

- Higher weekly payments (they must defer for a minimum of five weeks) – their State Pension increases by 1% for every five weeks they defer (equivalent to 10.4% for every full year)
- A lump sum payment which will include interest of 2% above the Bank of England base rate (they must defer for at least 12 months in a row)

Individuals who reach State Pension age on or after 6 April 2016

These people can only take the increased amount as a weekly payment. Their State Pension increases by 1% for every nine weeks they defer (equivalent to 5.8% for every full year). They must defer taking their State Pension for a minimum of nine weeks.

Annual increase

The extra amount someone receives through deferment normally increases each year in line with inflation (CPI). However, it does not increase for people living abroad in certain countries (please see below).

Living abroad

The rules on deferring a UK State Pension are the same as in the UK if someone moves to any of the following places:

- The European Economic Area (EEA)
- Switzerland
- A country which has a social security agreement with the UK (except Canada and New Zealand)

If someone moves to a country which is not on this list, then the following applies:

- The extra payment will not be increased over time
- If the individual reaches State Pension age on or after 6 April 2016, their extra payment will be based on the date they reach State Pension age or, if later, the date they moved abroad

If an individual defers, how much might they receive?

There are many reasons why an individual may or may not choose to defer their State Pension. Whether they should or not will depend on their personal and financial circumstances. Essentially there are no direct costs when deferring the State Pension. However, it does mean the person will not receive any State Pension income during the period of deferment.

Extra Income

The increase in the amount of State Pension income an individual may be entitled to receive from deferring can be calculated using the following formula:

Amount of increase = (1/number of weeks needed to defer) x (starting amount/100) x (number of weeks deferred for)

As an example:

Number of weeks deferred	52
Weekly state pension at date of claim	£164.35
Number of weeks needed to defer for	9
Amount of increase	£9.50 (1/9 x £164.35/100 x 52)
Total weekly pension after deferral	£173.85

Deferring the State Pension (continued)

Calculating the lump sum

The lump sum is based on the pension the individual would have been entitled to had they not deferred, plus a rate of return that will be applied weekly and compounded. The pension forgone will be calculated at the rate that would have been applicable in each week (or 'accrual period') for which the person defers.

Tax treatment

If the lump sum is taken it will be taxed at the marginal rate that applies to the individual's other income. It will not be added to any other income received during the year in which it is paid out, meaning they will not be pushed into a higher tax bracket as a result of claiming the lump sum. Individuals can also choose to delay receiving it until the following tax year when their income may be lower. The lump sum will not affect the age-related personal allowance.

Annual increase

The extra amount an individual earns from deferring is increased each year in line with prices (CPI). The triple lock arrangements that apply to the basic State Pension (BSP) and new state pension (NSP) do not apply to the extra amounts earned by deferral.

The tables on the following pages provide an indication of how much additional income or lump sum an individual might be able to receive from deferring their state pension.

State Pension Deferral – figures for those who reached SPA before 6 April 2016

Weekly State Pension	Years State Pension deferred for	Amount of State Pension given up	Deferred lump sum payment (gross)	Extra State Pension amount (gross)		Total amount of extra State Pension paid (gross)	
				Per week	Per year	After 5 years	After 10 years
£100	1	£5,200	£5,267	£10.40	£541	£2,704	£5,408
	2	£10,400	£10,667	£20.80	£1,082	£5,408	£10,816
	3	£15,600	£16,204	£31.20	£1,622	£8,112	£16,224
	4	£20,800	£21,881	£41.60	£2,163	£10,816	£21,632
	5	£26,000	£27,701	£52.00	£2,704	£13,520	£27,040
	6	£31,200	£33,669	£62.40	£3,245	£16,224	£32,448
	7	£36,400	£39,788	£72.80	£3,786	£18,928	£37,856
	8	£41,600	£46,062	£83.20	£4,326	£21,632	£43,264
	9	£46,800	£52,494	£93.60	£4,867	£24,336	£48,672
	10	£52,000	£59,090	£104.00	£5,408	£27,040	£54,080
£126	1	£6,552	£6,636	£13.10	£681	£3,407	£6,814
	2	£13,104	£13,440	£26.21	£1,363	£6,814	£13,628
	3	£19,656	£20,417	£39.31	£2,044	£10,221	£20,442
	4	£26,208	£27,569	£52.42	£2,726	£13,628	£27,256
	5	£32,760	£34,903	£65.52	£3,407	£17,035	£34,070
	6	£39,312	£42,423	£78.62	£4,088	£20,442	£40,884
	7	£45,864	£50,133	£91.73	£4,770	£23,849	£47,699
	8	£52,416	£58,038	£104.83	£5,451	£27,256	£54,513
	9	£58,968	£66,143	£117.94	£6,133	£30,663	£61,327
	10	£65,520	£74,453	£131.04	£6,814	£34,070	£68,141

Deferring the State Pension (continued)

The figures in the table are for illustration purposes only. The amounts actually payable and received by individuals may differ. This will depend on the actual number of weeks deferred and the rates of inflation applicable during the term of deferral.

These income figures have been prepared without taking into account yearly inflationary increases under the triple lock. The income figures shown are the potential amounts after the period of deferral has ended.

The lump sum figures in the table assume that the Bank of England interest rate remains at 0.5%. The lump sum increases at 2% above this. The actual lump sum individuals get will depend on interest rates, which may go up or down.

State Pension Deferral – figures for those who reached SPA before 6 April 2016 continued

Weekly State Pension	Years State Pension deferred for	Amount of State Pension given up	Deferred lump sum payment (gross)	Extra State Pension amount (gross)		Total amount of extra State Pension paid (gross)	
				Per week	Per year	After 5 years	After 10 years
£150	1	£7,800	£7,900	£15.60	£811	£4,056	£8,112
	2	£15,600	£16,000	£31.20	£1,622	£8,112	£16,224
	3	£23,400	£24,305	£46.80	£2,434	£12,168	£24,336
	4	£31,200	£32,821	£62.40	£3,245	£16,224	£32,448
	5	£39,000	£41,552	£78.00	£4,056	£20,280	£40,560
	6	£46,800	£50,503	£93.60	£4,867	£24,336	£48,672
	7	£54,600	£59,682	£109.20	£5,678	£28,392	£56,784
	8	£62,400	£69,093	£124.80	£6,490	£32,448	£64,896
	9	£70,200	£78,741	£140.40	£7,301	£36,504	£73,008
	10	£78,000	£88,634	£156.00	£8,112	£40,560	£81,120
£164	1	£8,528	£8,638	£17.06	£887	£4,435	£8,869
	2	£17,056	£17,494	£34.11	£1,774	£8,869	£17,738
	3	£25,584	£26,574	£51.17	£2,661	£13,304	£26,607
	4	£34,112	£35,884	£68.22	£3,548	£17,738	£35,476
	5	£42,640	£45,430	£85.28	£4,435	£22,173	£44,346
	6	£51,168	£55,217	£102.34	£5,321	£26,607	£53,215
	7	£59,696	£65,252	£119.39	£6,208	£31,042	£62,084
	8	£68,224	£75,541	£136.45	£7,095	£35,476	£70,953
	9	£76,752	£86,091	£153.50	£7,982	£39,911	£79,822
	10	£85,280	£96,907	£170.56	£8,869	£44,346	£88,691

Deferring the State Pension (continued)

State Pension Deferral – figures for those who reached SPA after 6 April 2016

Weekly State Pension	Years State Pension deferred for	Amount of State Pension given up	Extra State Pension amount (gross)		Total amount of extra State Pension paid (gross)	
			Per week	Per year	After 5 years	After 10 years
£100	1	£5,200	£5.78	£300.00	£1,502	£3,004
	2	£10,400	£11.56	£601.00	£3,004	£6,009
	3	£15,600	£17.33	£901.00	£4,507	£9,013
	4	£20,800	£23.11	£1,202.00	£6,009	£12,018
	5	£26,000	£28.89	£1,502.00	£7,511	£15,022
	6	£31,200	£34.67	£1,803.00	£9,013	£18,027
	7	£36,400	£40.44	£2,103.00	£10,516	£21,031
	8	£41,600	£46.22	£2,404.00	£12,018	£24,036
	9	£46,800	£52.00	£2,704.00	£13,520	£27,040
	10	£52,000	£57.78	£3,004.00	£15,022	£30,044
£126	1	£6,552	£7.28	£379.00	£1,893	£3,786
	2	£13,104	£14.56	£757.00	£3,786	£7,571
	3	£19,656	£21.84	£1,136.00	£5,678	£11,357
	4	£26,208	£29.12	£1,514.00	£7,571	£15,142
	5	£32,760	£36.40	£1,893.00	£9,464	£18,928
	6	£39,312	£43.68	£2,271.00	£11,357	£22,714
	7	£45,864	£50.96	£2,650.00	£13,250	£26,499
	8	£52,416	£58.24	£3,028.00	£15,142	£30,285
	9	£58,968	£65.52	£3,407.00	£17,035	£34,070
	10	£65,520	£72.80	£3,786.00	£18,928	£37,856

Deferring the State Pension (continued)

The figures in the table are for illustration purposes only. The amounts actually payable and received by individuals may differ. This will depend on the actual number of weeks deferred and the rates of inflation applicable during the term of deferral.

These income figures have been prepared without taking into account yearly inflationary increases under the triple lock. The income figures shown are the potential amounts after the period of deferral has ended.

State Pension Deferral – figures for those who reached SPA after 6 April 2016 continued

Weekly State Pension	Years State Pension deferred for	Amount of State Pension given up	Extra State Pension amount (gross)		Total amount of extra State Pension paid (gross)	
			Per week	Per year	After 5 years	After 10 years
£150	1	£7,800	£8.67	£451.00	£2,253	£4,507
	2	£15,600	£17.33	£901.00	£4,507	£9,013
	3	£23,400	£26.00	£1,352.00	£6,760	£13,520
	4	£31,200	£34.67	£1,803.00	£9,013	£18,027
	5	£39,000	£43.33	£2,253.00	£11,267	£22,533
	6	£46,800	£52.00	£2,704.00	£13,520	£27,040
	7	£54,600	£60.67	£3,155.00	£15,773	£31,547
	8	£62,400	£69.33	£3,605.00	£18,027	£36,053
	9	£70,200	£78.00	£4,056.00	£20,280	£40,560
	10	£78,000	£86.67	£4,507.00	£22,533	£45,067
£164	1	£8,528	£9.48	£493.00	£2,464	£4,927
	2	£17,056	£18.95	£985.00	£4,927	£9,855
	3	£25,584	£28.43	£1,478.00	£7,391	£14,782
	4	£34,112	£37.90	£1,971.00	£9,855	£19,709
	5	£42,640	£47.38	£2,464.00	£12,318	£24,636
	6	£51,168	£56.85	£2,956.00	£14,782	£29,564
	7	£59,696	£66.33	£3,449.00	£17,246	£34,491
	8	£68,224	£75.80	£3,942.00	£19,709	£39,418
	9	£76,752	£85.28	£4,435.00	£22,173	£44,346
	10	£85,280	£94.76	£4,927.00	£24,636	£49,273

Payment and tax treatment of the State Pension

How the State Pension is paid

The State Pension is usually paid into the claimant's account every four weeks. The new State Pension is paid in arrears.

The government's preferred method is direct payment into a bank, building society or credit union account. However, there is also the option of payment into a Post Office Card Account until at least 2021.

When the State Pension is paid

The day the State Pension is paid depends on a person's National Insurance number:

The last two digits of the person's NI number	Payment day of the week
00 to 19	Monday
20 to 39	Tuesday
40 to 59	Wednesday
60 to 79	Thursday
80 to 99	Friday

There are different rules for people who live abroad.

The rules on when a State Pension starts and ends are different under the old and new schemes.

Old scheme	New scheme
Generally, only the State Pension is payable for complete weeks • No State Pension was paid for the days falling before the start of the person's first benefit week • When the pensioner dies, their State Pension is payable to the end of that benefit week	The State Pension is payable from the day on which a person reaches State Pension Age up to and including the date of their death. Individuals may have to wait a few days for their first payday (as under the old scheme), but they will receive an amount in arrears to cover the gap.

Tax treatment

Although tax is never deducted from a State Pension, the amount paid is aggregated with any other income an individual may have to establish if there is a tax liability.

Inheriting a State Pension

The basic State Pension

If a spouse or civil partner reached State Pension age before 6 April 2016, they should contact the Pension Service following the death of their partner to check whether they are entitled to claim. They may be able to increase their basic State Pension by using qualifying years built up by their partner if they do not already qualify for the full amount.

If a recipient of the basic State Pension dies when they are single, divorced or where their civil partnership has been dissolved, their estate may be able to claim up to three months of the deceased's State Pension (but only if the pension hasn't been claimed).

The Additional State Pension

A spouse or civil partner may be able to inherit an Additional State Pension following the death of their partner:

- **If the surviving spouse or civil partner is under the State Pension age**

  They may inherit an Additional State Pension if they receive Widowed Parent's Allowance (WPS), although if WPS ends the Additional State Pension ends too. It may be paid again when the individual reaches State Pension age if, for example, they haven't remarried or formed a new civil partnership. If the surviving partner receives Bereavement Allowance, they will only inherit any Additional State Pension once they reach State Pension age, and only if they haven't remarried or formed a new civil partnership.

- **If the surviving spouse or civil partner has reached State Pension age**

  The maximum amount that can be inherited by the surviving spouse depends on when the deceased died:

<table>
<tr><th>Date the deceased spouse died</th><th colspan="2">SERPS / State Second Pension (S2P)</th></tr>
<tr><td>Before 6 October 2002</td><td colspan="2">• Up to 100% for SERPS
• N/A for S2P</td></tr>
<tr><td>On or after 6 October 2002 and reached State Pension age before 6 October 2002</td><td colspan="2">• Up to 100% for SERPS
• N/A for S2P</td></tr>
<tr><td rowspan="7">On or after 6 October 2002 but did not reach State Pension age before 6 October 2002</td><td colspan="2">Depends on the date the deceased reached State Pension age:</td></tr>
<tr><th>Date</th><th>Maximum entitlement</th></tr>
<tr><td>6.10.02 to 5.10.04</td><td>90%</td></tr>
<tr><td>6.10.04 to 5.10.06</td><td>80%</td></tr>
<tr><td>6.10.06 to 5.10.08</td><td>70%</td></tr>
<tr><td>6.10.08 to 5.10.10</td><td>60%</td></tr>
<tr><td>6.10.10 or later</td><td>50%</td></tr>
</table>

The new State Pension

Someone may inherit an extra payment on top of their new State Pension if they are widowed, but only if they do not remarry or form a new civil partnership before they reach State Pension age:

- **Protected payments**

  Any amount the contributor had built up by April 2016 under the old system that was in excess of the full amount of the new State Pension. An individual can inherit 50% of their partner's protected payment if the marriage or civil partnership began before 6 April 2016 and their partner:

  – Reached State Pension on or after 6 April 2016

  – Died on or after 6 April 2016

  It will be paid with the State Pension.

Inheriting a State Pension (continued)

- **Deferred payments**

  An individual may be able to inherit a partner's extra State Pension or lump sum if their late spouse or civil partner reached State Pension age before 6 April 2016 and put off claiming their State Pension.

A person can contact the Pension Service to check if they are able to claim Additional State Pension based on the NI record of another individual.

Inheriting a deferred State Pension

Someone can normally inherit a partner's extra State Pension if all of the following circumstances apply:

- They were married or in a civil partnership when their partner died
- Their partner reached State Pension age before 6 April 2016
- They didn't remarry or form a new civil partnership before they reached State Pension age
- Their partner had deferred or was claiming a deferred State Pension when they died

If the partner died before 6 April 2010, one of the following must also apply:

- They were over State Pension age when their partner died
- Women who were under State Pension age when their husband died

If the partner reached State Pension age after 6 April 2016, deferred taking their State Pension and then subsequently died before making a claim:

- The most that falls due to the deceased's estate is three months of backdated State Pension payments
- There is no general entitlement for the surviving spouse or civil partner to inherit the pension payments that were never paid

Receiving inheritance payments from a deferred State Pension

How someone receives an inherited deferred State Pension depends on whether it was claimed or not before the deceased past away:

- If the partner died before claiming their State Pension, payment depends on how long the pension was deferred for:
  - A year or more: the surviving partner can choose to inherit a lump sum or weekly payments
  - Between five weeks and a year: the payments are received as weekly payments
  - Less than five weeks: the deferred payments will form part of the deceased's estate
- If the partner was claiming their State Pension before they died, the surviving partner will receive payments as extra weekly payments

Important information

This document provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations.

This document represents a summary of our understanding of the law at the date of its last review (March 2018). Tax limits, benefits, allowances and rules are often subject to change and may change in future. Advisers and individuals should check that tax limits, allowances and rules have not changed.

The value of benefits depends on individual circumstances. Withdrawals from a pension will not normally be possible until age 55.

Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning.

2. A guide to pensions and divorce

In divorce settlements, more often than not, there are two large assets to be considered – the main residence and any pension rights. After the matrimonial home, the pension fund is, for many people, the most substantial financial investment they will ever make. It is also a resource which is most likely to be lost to one party (traditionally the wife/civil partner) on divorce if no action is taken. In terms of dividing these two resources on divorce, each has its own problems – the residence is mainly indivisible and the pension rights require real expertise and a professional crystal ball to value, as the ultimate value of the pension on retirement is likely to be unknown at the point of divorce.

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Since the Matrimonial Causes Act 1973 (MCA1973), courts in England and Wales have had the power to take the value of personal and occupational pensions into account when settling the matrimonial estate, although this is not compulsory. The Matrimonial Causes (Northern Ireland) Order 1978 gave similar provisions to courts in Northern Ireland, and the Family Law (Scotland) Act 1985 set out the principles to be applied in Scotland.

There are key differences between the law for Scotland and for the rest of the UK. While an attempt has been made to point these out where appropriate, not every difference can be taken account of in this document and specialist advice may be needed.

The present law on the subject of pensions remains complicated. There are various ways in which courts may deal with a pension on divorce. These can be summarised as follows:

- Offsetting (regardless of the date of the petition)
- Pension attachment/earmarking (where the petition was filed on or after 1 July 1996)
- Pension sharing (where the petition was filed on or after 1 December 2000)

Principles behind the courts' decisions

In reaching a financial settlement on divorce, it is clear that identification of fault has no part to play in how the assets are apportioned. The law will recognise the part played by both parties in creating wealth, whether it be directly (such as salary and bonus) or by enabling the spouse or civil partner to create the wealth by, for instance, running a home.

With regard to considering any pension assets, pensions are part of the overall exercise to be performed under the Matrimonial Causes Act 1973. Following **White v White**[1], the courts will be concerned with equality of outcome and overall fairness, taking into account the contributions of both parties.

A pension fund is a resource like any other. Although capital assets and pension assets are different in nature, the value of any pensions must be included in any list of assets supplied to the court. This is typically supplied in a court form referred to as Form E. For more detail, see **'The legal divorce procedure'** (page 32). This allows the court's attention to be focused on the totality of the parties' assets. The courts do not, however, have to make an order in respect of pension benefits. The options on division of pension benefits are considered along with other options available to distribute the marital assets.

In ascertaining the value of the pensions to be used, in principle the courts must rely on the cash equivalent transfer method for the purposes of this calculation (referred to as a **cash equivalent transfer value** or **CETV**). They may be persuaded to take other matters into account, if supported by expert evidence. For instance, the CETV method may provide an inadequate indication of the value of future expectations for death-in-service or discretionary benefits.

The valuation is typically undertaken to show the value of the pension at the date of divorce or thereabouts or date of official separation in Scotland (i.e. it is not usual to attempt to project the level of pension that will have accrued by retirement).

In Scotland, the courts have historically only tended to take into account benefits **earned during the marriage**. However in McDonald v Newton, it was decided that the period of membership in regulation 4 of the 2000 pension sharing regulations refers to the period of the person's membership of the pension arrangement, irrespective of the type of membership. The effect is that rather than being able to calculate the value of the pension looking at active membership only, parties will now have to rely upon the Courts to use their flexibility and discretion in relation to proportions of a pension valuation that may have accrued from contributions made by pre-marriage.

Outside of Scotland, the courts will not apportion/carve out the benefits in accordance with the period of the marriage. This means that all pension benefits, including those earned before the marriage, are taken into account (except any already earmarked from an earlier divorce).

These are complicated issues and where this is not a specialty area, input from a pension consultant/actuary may be needed.

Offsetting

Offsetting is arguably the simplest and cleanest method of dealing with pension benefits on divorce. In this scenario, the court will start from a consideration of all of the couple's assets, that is, including the value of all non-pension and pension assets and any income being received, before deciding how to divide the couple's matrimonial estate.

Once the values have been established, the value of the pension rights can then be weighed/offset against other matrimonial assets, such as the family home or other savings. In essence, the ex-spouse/former civil partner gets another asset, or share of another asset (up to the appropriate value of the share of the pension) instead of a share of the pension.

[1] White v White [2000] UKHL 54

As an example:

The court has decided to split all of a couple's assets 50/50. The husband has a pension through his work but his wife does not. The pension fund is worth £150,000 and the couple's home is worth £300,000. The court decides that the husband can keep his pension arrangement in his own right but his wife is then entitled to £225,000 of the house proceeds.

This method was initially used as the courts were unable to compel the pension holder to set aside any of their pension benefit for their ex-spouse/former civil partner.

Benefits

The main benefits of this approach are:

- It keeps the resulting transactions relatively simple along with a cleaner break
- Depending on the circumstances, the solution may be better suited to meet the couple's individual circumstances, especially when both parties are financially successful and each has substantial pension provision
- One party may have a need for the use of other assets (for example, a home)
- If one party is likely to die before retirement, it may be preferable to receive a benefit now by way of other assets
- If the pension is small, making a pension sharing order will likely be expensive/disproportionate
- Offsetting orders are unaffected by remarriage or death

Drawbacks

The main drawbacks with this approach are:

- One of the parties may be left with little or no provision for retirement. Depending on their proximity to retirement this could be quite disadvantageous for them
- It may also not fully account for the tax situation of the respective assets, that is, the pension benefits taken will most likely be paid minus tax on 75% of the funds

Attachment orders/earmarking

This method was introduced under the Pensions Act 1995 for divorce petitions filed on or after 1 July 1996 (or 19 August 1996 in Scotland) It may also be used for annulment and judicial separation.

Earmarking refers to an attachment order made by the court which requires a proportion of the pension benefits to be paid directly to an ex-spouse/former civil partner, instead of to the member. It is in effect a form of deferred maintenance. The benefits continue to be held in the original member's plan until the member starts drawing an income (and/or when they die), when the benefits will be paid to the respective parties in the proportions required by the earmarking order.

Earmarking orders in **England, Wales and Northern Ireland** may be made against a member's:

- pension commencement lump sum
- pension income
- death-in-service lump sum death benefits

In Scotland, only the tax-free cash lump sum and lump sum death benefits can be earmarked rather than pension income.

The amount is specified at the time of the divorce but either party can apply to the court to have the amount varied. In practice, an agreement in principle is likely to be made between the parties before being ratified by the courts. Earmarking cannot take place without the courts' involvement. More about the process for financial settlement on divorce is explained later in this guide.

As an example:

An attachment order could be added to a member's pension stipulating that when they retire and draw income from the pension, 50% of the income they receive must be paid to their ex-spouse/former civil partner.

Where an earmarking order includes lump sum death benefits, the order can compel the inclusion of the ex-spouse/former civil partner as a beneficiary, thereby overriding the normal discretion that administrators/trustees have over the selection of beneficiaries who receive death benefits. This power does not extend to the redirection of dependant's pensions on the member's death.

State Pension benefits, including State Second Pension (S2P), cannot be made the subject of earmarking orders. While a divorced person can claim the contribution record of the ex-partner for the basic State Pension, it is not possible to do the same for any state earnings related pension scheme (SERPS)/(S2P) benefits. This will also not be possible for the new single-tier State Pension, although pension sharing will be available if there is a protected payment.

If the member subsequently transfers any of their pension benefits that have been subject to an earmarking order, the scheme trustees would have to inform the new trustees/providers of the earmarking order. They must also notify the ex-spouse/former civil partner within 21 days of the transfer.

When the member dies after commencing benefits, the pension to the ex-spouse/former civil partner will also cease. There are normally no subsequent widow's benefits either, though this could be included in the earmarking order, particularly if the ex-spouse/former civil partner was clearly financially dependent on the member pre-divorce.

The court could decide, as in the case of **T v T**[1], to defer deciding on an earmarking order until nearer the member's actual retirement date.

Benefits

The main benefits of this approach are:

- It allows for both the tax-free cash benefit and the pension income benefit to be earmarked
- Death-in-service benefits can also be earmarked
- An earmarking order may be used in cases of judicial separation, not just on divorce
- If the member transfers pension rights, the earmarking order will follow the member's rights to the new arrangement
- The ex-spouse/former civil partner is not reliant on their ex-partner to arrange payment but rather on an independent third party
- The ex-spouse/former civil partner will have some provision in retirement

On the whole, as a remedy it is largely unsatisfactory and is seldom used in recent years, in view of its inherent drawbacks.

[1] T v T (Financial Relief: Pensions) [1998] 1 FLR 1073 HC

Drawbacks

The main drawbacks of this approach are:

- It does not allow a clean break between the divorcing couple and the couple may need to keep in touch many years after the divorce
- The ex-spouse/former civil partner will need to keep the scheme trustees advised of any changes in his or her circumstances
- Earmarking orders in respect of pension benefits (including a pension in payment) cease on the remarriage of the party receiving the award
- If the member or ex-spouse/former civil partner dies, the earmarking order/payments of any pension will cease
- Where benefits are defined contribution, the investment risk profile of the member and/or the objectives at retirement may be different to those of the ex-spouse/former civil partner. This can cause serious issues if the member has a high-risk strategy and a market crash leads to a significant fall in the fund value near retirement, thereby reducing the resulting benefits just as they are due to be paid
- The basis of benefits under the member's scheme may change between the time the court order on divorce is made and when the member retires, so there is no certainty for the ex-spouse as to how much they will receive
- There can be no certainty over when the member will draw his or her benefits, if at all. The earmarking order cannot require the member to draw such benefits on a particular date
- Any earmarked pension benefit payable to the ex-spouse/former civil partner is treated as part of the member's pension entitlement for lifetime allowance purposes
- The member retains the liability for the income tax on the whole pension, even the part of the pension that is earmarked to the ex-spouse/former civil partner, meaning they may have to pay tax on an income they will not be in receipt of. (If the member is a high rate taxpayer this may be particularly disadvantageous for both parties as the pension the ex-spouse/former civil partner receives will be net of tax based on the member's tax position)
- Although there is no further tax liability on the ex-spouse/former civil partner in relation to the income received, the ex-spouse/former civil partner cannot reclaim the tax deducted, even if they are a non-taxpayer
- The form of benefits provided to the ex-spouse must match those taken by the member

Pension sharing

Introduced in the Welfare Reform and Pensions Act 1999, pension sharing enabled the courts to split pension rights between a husband and wife or civil partners at the time of the divorce. The legislation became effective on starting on or after that date. It does not apply retrospectively.

The primary objective of pension sharing was to give couples and the courts greater flexibility and choice, by allowing pension rights to be treated in a way which provides for the fairest overall settlement of assets in each case.

The aim of pension sharing is to separate the ex-spouse's/former civil partner's pension entitlement from the member's pension so that there is a clean break.

In England and Wales, a pension sharing order can only be expressed as a percentage of the cash equivalent transfer value (CETV) as defined in the Matrimonial Causes Act 1973, s.21A(b) and subsequently clarified in **H v H.**[1]

In Scotland, a monetary amount or a percentage of the CETV can be specified. This is particularly important given that the value of the pension may have changed substantially between the point of separation and the date that the pension debit (see next paragraph) is actioned.

When a pension sharing order is issued a 'pension debit' will be created in relation to the member's rights (that is, the amount to be deducted) and an equivalent 'pension credit' will be provided for the ex-spouse/former civil partner.

Pension sharing orders can be made in respect of:

- Occupational schemes, including AVCs
- Registered individual pension schemes (for example, personal pensions, stakeholder pension, retirement annuity contracts and section 32s)
- Statutory schemes (for example, public sector schemes)
- Unapproved schemes (for example, employer-financed retirement benefit schemes)
- State earnings related pension scheme (SERPS) and State Second Pension (S2P), where State Pension age was reached before 6 April 2016

They can be ordered against active, deferred and pensioner members and will apply to contracted-out benefits in the same way as they would to other benefits.

[1] H v H [2010] EWHC 158 (Fam)

The following pensions cannot be shared:

- Basic State Pension
- Graduated pension
- Widow or widower's pension that is in payment

In a defined contribution arrangement, the pension debit is simply a reduction in the value of the pension holder's fund.

Where defined benefit schemes are involved, matters become more complicated. The pension debit equates to a proportion of the benefits that would be payable to the member at their Normal Scheme Retirement Date. Ordinarily the pension would therefore be a split of the CETV calculated in the normal way (that is, with the scheme benefits revalued to the date of retirement and deducted back from the final benefits and the cost capitalised). However, alternative approaches are possible.

Couples divorcing in Scotland can reach a pension share agreement by a court order or by completing a registered Minutes of Agreement. However, in both England and Wales, this can be achieved only by a court order.

The options available to the ex-spouse/former civil partner will depend on the type of scheme to which the member belonged and the rules of that scheme.

All providers of funded pension arrangements (excluding those transferred to the Pension Protection Fund (PPF) and any pensions already in payment), must allow the ex-spouse/former civil partner to transfer a pension credit to another registered pension scheme of the ex-spouse's/former civil partner's choosing, subject to the receiving pension arrangement being able to accept the transfer.

Where the individual is a member of an unfunded pension scheme (for example, most public sector schemes such as the Civil Service scheme and the Teachers' scheme), the pension credit rights in respect of the ex-spouse/former civil partner must be retained under the scheme.

Other schemes may at their discretion offer the ex-spouse/former civil partner membership of the scheme in their own right. In this instance they would enact an 'internal transfer'. Where this is offered, the pension credit benefits are not required to be on the same basis as those in the scheme. For example, the pension credit may be on a defined contribution basis even though the scheme is a defined benefit or career average scheme.

Schemes are however permitted to insist on a transfer out. In this instance, the member will initially be given the choice of selecting the receiving scheme. Where a choice is not forthcoming from the ex-spouse/former civil partner, the scheme may give notice that they intend to transfer the benefits to a default s.32 arrangement of their choosing. A transfer to a personal pension cannot be used as a default under current legislation.

If a pension credit is awarded in relation to a scheme that has been transferred to the PPF, the PPF will pay compensation to the ex-spouse/former civil partner, who will not be allowed to transfer out of the scheme.

The ex-spouse/former civil partner could become entitled to a share of the pension holder's SERPS/S2P benefit (a 'shared additional pension'), but this would not be transferable in any way.

The new single-tier State Pension was introduced in April 2016. Pension sharing cannot be applied to the new single-tier pension. However, existing sharing orders will be honoured and the new rules allow for the sharing of protected payments when these are awarded. Protected payments apply when the value of the current State Pension benefits in April 2016 exceed the value of the State Pension when the new rules are applied.

Pension Schemes are permitted to charge for dealing with the administration of pension sharing orders. This is to protect the scheme from the cost involved in administering pension sharing being borne by the scheme, other members or the taxpayer. The court order should state how any charges are to be apportioned and, if silent, these are to be borne by the member.

The Regulations do not specify limits on the charges, but, if the scheme requires charges to be paid, the divorcing couple must be notified of the applicable charges before the order/agreement is made. The scheme will usually seek to only charge what is reasonable in order to comply with statutory requirements relating to charges and to avoid complaints.

Costs not directly relating to the implementation of a specific divorce order, for example, amending the scheme rules, training administration staff and altering computer systems, will be borne by the scheme and may not be charged to the divorcing couple.

The Pensions and Lifetime Savings Association (PLSA) produces a table of recommended charges to be used as a guide to the industry. This can be found on the PLSA website. Schemes are not required to follow the PLSA rates.

The process undertaken by pension providers/trustees on receipt of a pension sharing order is explained later in this guide.

Once transferred, there are generally no restrictions on how pension credit benefits can be taken other than any standard legislative and tax requirements, such as the minimum pension age being met and any rules under the new scheme that may apply.

The pension sharing order may be made where the member has already commenced benefits, for instance where the member has already entered drawdown and taken their Pension Commencement Lump Sum (PCLS). These are called disqualifying pension credits. Here, the ex-spouse/former civil partner receives the pension credit as an uncrystallised benefit with no PCLS entitlement. If they are 55 or over they can put the pension into income drawdown and take income, but will not receive any PCLS.

Annual allowance

A pension credit will not be tested against the non-member ex-spouse/former civil partner's annual allowance provided it comes from another registered pension scheme. Any contributions made to the pension prior to the implementation of the pension sharing order would be tested against the member's annual allowance for the relevant pension input period in question.

More detail on how pension sharing interacts with the lifetime allowance is provided on page 34.

Advantages of pension sharing:

- It achieves a clean break
- It helps to ensure both parties will have pension provision available in retirement
- Provides security for the non-pension member ex-spouse/former civil partner who will have ownership of their own scheme, which is not in any way dependent on the member
- A share of the capital is provided, which may be needed to help one party re-house or meet other immediate financial commitments (subject to being over normal minimum pension age and the pension not being in payment already)
- Each party will receive the full benefit of any pension contributions they make following the split
- Remarriage, death or other change in circumstances will not affect the order

Disadvantages of pension sharing:

- The member's future lump sum and income provision will be reduced
- The actual debit (the reduction in pension as a result of the order) will not be known until retirement
- An implementation fee will be payable to the pension provider which can be significant and may be disproportionate to the benefits of the pension
- The non-pension member ex-spouse/former civil partner may not be able to receive the pension until the date specified by the rules of the member's pension scheme, or the rules of any scheme the pension credit is transferred to
- It may be difficult to split some pensions. For instance a Small Self-Administered Pension Scheme (SSAS) could have investments in commercial property which is used by the members' business, making it difficult to obtain an accurate valuation and implement the order. The scheme may need to raise money in order to pay out the non-member ex-spouse/former civil partner, and where there are other members, the other members will need to give agreement to the pension sharing order
- For high earners, care may be needed because of the effect the pension credit has on the recipient's lifetime allowance, that is, adding additional funds – which need to be tested for lifetime allowance (LTA) purposes – could mean they become liable to an LTA charge when tested (see page 34 for more details on LTA implications)

Impact of pension freedoms

Offsetting

When establishing the value to apply to pension assets during the divorce procedure, it has been commonplace to discount the value of a pension in view of the uncertainty of its true eventual value – this is particularly relevant when assessing the value of pensions and annuities already in payment.

As those divorcees aged 55 or over now have complete access to any defined contribution pension funds, there is less of an argument for discounting the value of those assets. This could lead to greater parity of value when comparing against other assets.

Earmarking orders

When earmarking orders were created, full access to defined contribution pensions was not available. As a result, unless the details in the earmarking order are very clear and specific, pension freedoms could have unintended consequences for the recipient. The rationale for this is that it may allow the pension member, in certain scenarios, to circumvent the original intentions set out in the order. For example, if the earmarking order doesn't specify exactly when and how benefits must be taken, and/or doesn't specify a requirement to take the PCLS, then the order could potentially be circumvented by taking an Uncrystallised Fund Pension Lump Sum (UFPLS) (which doesn't technically include a PCLS). Then, if there are no pension funds left to crystallise, there is no income left to be covered by an income earmarking order.

In consultation paper 15/30 the Financial Conduct Authority (FCA) acknowledged the potential implications of pension freedoms as set out above. In Policy statement 16/12 (the FCA's feedback to the responses it received on CP15/30 and final rules and guidance), the FCA reiterated the need for advisers to enquire as to the existence of any pension attachment/earmarking orders and take these into account when providing advice to their clients. There was also a requirement for pension providers to ensure they are complying with the obligations of the orders and making sure they provide notices to other parties where relevant events occur, such as transfers and significant reductions in benefits. In terms of altering the rules, the FCA responded by stating that ultimately it is for the courts to vary any attachment order that may not work as intended should the member take advantage of the pension freedoms to access the pension benefits, and that their guidance will help ensure that attachment orders are taken into account by both providers and advisers.

It may therefore be worth revisiting clients who have an earmarking order in force and, if necessary, considering a return to the courts to get the order's intention clarified. There are no time restrictions on doing this, though inevitably there is an element of cost involved.

This issue was consulted on by the Department for Work and Pensions (DWP) in November 2015 and it was proposed that schemes should be required to notify a former spouse when a member applies to take their benefits flexibly. This was proposed to give the former spouse time to apply to court to vary the earmarking order if the outcome was not what the original order intended. The responses indicated various views and so the DWP has delayed any amendment to the current position.

Pension sharing

As explained above, the ex-spouse/former civil partner will have complete control as to how they use the proceeds they receive as a pension credit. That being said, the options available in terms of accessing the pension after age 55 will depend on the options available in the scheme that the pension credit is moved to. Some schemes, like occupational schemes, do not offer full access to all the freedoms and will be subject to their own rules on points such as consents and minimum age requirements. Therefore, if the ex-spouse/former civil partner has an intended and quick need to access the pension, consideration of where the pension credit will be moved to following the split will be important.

In addition, after April 2015, the ex-spouse/former civil partner may prefer to have cash rather than a share of a pension fund. If the member is over 55, this is possible, even if the ex-spouse/former civil partner is much younger, as the right to access the pension fund is linked to the member's age.

The courts could therefore decide for monies to be paid from the pension now instead of the pension being shared as an UFPLS, or a series of UFPLS, for instance. However, that could result in serious tax implications for the member and also restrict tax relief on future contributions to defined contribution pension arrangements (because of the Money Purchase Annual Allowance).

Considerations when reviewing options with reference to pension freedom reforms

Two key considerations on deciding which option to proceed with are how tax and any planned future contributions could be impacted by accessing pensions under the freedom reforms.

Tax and future contribution issues (that is, the impact of the money purchase annual allowance) when utilising this flexibility, will of course, need to be considered as part of the settlement discussions.

Tax

The tax applied to a withdrawal from a pension scheme will depend on the option taken. For example:

- For payment of an UFPLS, 25% of the sum taken is tax-free and 75% is taxed as income
- For payment of a PCLS and scheme pension or annuity, 25% of the overall value of the accrued benefits may be taken as a PCLS (tax-free lump sum) with the pension being chargeable to income tax
- For flexi-access drawdown, pension income is chargeable to income tax

A significant withdrawal from a pension therefore has the potential to attract income tax at a higher rate than the relief on the original contribution, especially where the total income for the year exceeds £100,000, resulting in the reduction/loss of a personal allowance. A withdrawal that pushes income over £50,000 in a tax year will start to cause the loss of Child Benefit.

However, the introduction of the flexible options enables individuals to consider the amount of pension income (and total income including pension) that they will receive in a year and choose to only take a proportion of their accrued benefits so as to avoid paying higher rates of income tax.

Future contributions

If a pension member or the ex-spouse makes a taxable withdrawal from their pension fund using a flexible pension option, their annual allowance would be reduced from the current £40,000 to £4,000 for contributions to a defined contribution scheme. This will significantly reduce their ability to make future pension savings and is designed to restrict 'recycling' of pension income to take advantage of tax benefits. Individuals who are taking a flexible withdrawal while remaining an active contributor to a pension scheme, will need to tread carefully before deciding to take a withdrawal as it could impact on the tax efficiency of any pension contributions paid by an employer or the individual. In particular, individuals who remain in employment and will be in receipt of employer contributions (which could include auto enrolment membership i.e. where an employee joins a scheme automatically in order to meet the employer's auto enrolment obligations, subject to opting out).

Overseas aspects

The UK courts have no jurisdiction on overseas pension schemes and so it is very unlikely that an overseas-based pension scheme will recognise a pension sharing order or attachment order from a UK court. A pension attachment order may have more chance of being recognised and enforced, but local advice will be necessary. The 2016 case of Goyal v Goyal being the most recent authority on this.

It may therefore be more sensible, where there are other assets, to look first at other solutions while leaving the overseas pensions untouched. Failing this, it may be worth considering an agreement between the parties to make a joint approach to the relevant overseas court to implement a local form of pension sharing order.

Equally, courts dissolving a marriage outside the UK have no jurisdiction on UK-based pension schemes.

However, legislation does generally require UK courts, when taking account of UK pension benefits, to consider foreign divorce decrees in the same way as they would a domestic divorce.

In England, Wales and Northern Ireland the policyholder's ex-spouse/former civil partner could, following an overseas divorce, make an application for financial relief in the courts to get an earmarking or pension sharing order if they have suffered hardship by reason of the foreign divorce.

In Scotland a court order is not required to split a pension – it can be done by mutual agreement.

Finally, it may be possible to transfer a pension credit to an overseas pension scheme subject to meeting the specified conditions for such a transfer.

The legal divorce procedure

The process starts when one spouse/civil partner files a petition for divorce. This spouse/civil partner is now known as the **petitioner**. The divorce papers are filed by the petitioner in court – the court issues them and serves a copy on the other spouse/civil partner, known as the **respondent**.

Once the respondent has been served with the papers, they should return an Acknowledgement of Service to the court. The petitioner then requests that the court set a date for the decree nisi hearing. The decree nisi is then pronounced and sent to both parties. This is the first stage of the legal dissolution of the marriage. The decree nisi will be granted by the court if the initial application is successful.

At this stage, the parties to the divorce will usually decide whether to seek financial settlement through the courts or reach an informal settlement.

In order to finalise the divorce, the court must issue a further decree called the decree absolute. The petitioner may apply for this at any time from six weeks and a day after the pronouncement of the decree nisi.

Alternatively, the respondent may apply for the decree absolute three months after that period has expired.

The marriage is officially ended when the decree absolute is granted. Accordingly, any agreement that is to be 'blessed' by the court, or agreed using the financial order proceedings, must be completed before the decree absolute is granted.

Financial settlement procedure

Many people going through the divorce process will not have to use the courts to sort out their finances. A divorce settlement can be reached through other means, such as through family mediation or collaborative law.

For those who do go through the courts a separate legal process known as **financial order proceedings** will take place.

The process begins with **Form A** being filed and served.

The court then sets the date for the **first directions appointment (FDA)** and dates for the **completion of Form E** (usually they must be submitted at least 35 days before the first appointment).

Form E requires each party to disclose their full financial circumstances (called financial disclosure). This includes providing information about their pension rights.[1] Once the FDA documents have been filed and served an estimate of costs will also need to be filed via **Form H**.

Often a financial agreement will be reached between the parties' solicitors and then simply ratified by the court.[2] This can happen here or at the second hearing.

The second hearing is the **financial dispute resolution (FDR)** hearing – this is a without prejudice hearing where the judge will try to assist a settlement of financial issues. Most cases settle here or just after and the court makes a final order on the agreed terms.

If terms can't be agreed here there will be a **final hearing** – the court will listen to evidence, grant orders and give reasons.

On receipt of a valuation request, the pension scheme provider/trustees have up to 6 weeks to supply the valuation where proceedings have commenced or up to three months where the scheme has not been notified that proceedings have commenced. It may be shorter if the court order dictates.

[1] Once the court instruction to complete Form E is made, each party has seven days to request the relevant information from the trustees of their pension arrangement(s). The member may use a valuation already obtained under the divorce, disclosure or cash equivalent legislation but the valuation date must not be more than 12 months before the date fixed for the first appointment.

[2] It is good practice to send a copy of the draft pension order to the pension scheme administrator, prior to this going through the courts, to enable them to check that they will be able to implement the order once it is made final. See the next page for further information.

The following information must be provided by the pension scheme provider/trustees:

- The Cash Equivalent Transfer Value (CETV) of the pension rights accrued to date
- The pension benefits included in the valuation
- A statement summarising how the CETV has been calculated
- A schedule of any charges which will apply

For pension sharing orders it must also include details of:

- How the scheme treats any pension credits (scheme membership or external transfer)
- Whether the scheme offers membership to a person entitled to a pension credit, and if so, the types of benefits available (internal CETV and services provided)
- Whether the scheme intends to discharge its liability for a pension credit other than by offering membership to the ex-spouse/former civil partner (default option)

Earmarking process following the valuation request

If there is no pre-agreement, the court will consider what proportion of benefits should be earmarked.

Once determined, the court will issue an order setting out the terms of the attachment/earmarking.

Upon receipt of the earmarking order, the provider/trustees have 14 days to voice any objections to the order. Reasons why they may want to object include where the order states that the scheme/provider is to arrange for the split, rather than the member accessing the pension and passing on the attached/earmarked payments to the ex-spouse/former civil partner. In this instance it could mean that the provider has to deduct the tax and then split the net payment out between the member and ex-spouse/former civil partner, resulting in additional administration costs that the scheme is unable to recover.

If the pension benefits are subsequently transferred, the receiving scheme or provider must be given a copy of the attachment/earmarking order by the transferring scheme.

The ex-spouse/former civil partner should be informed of the transfer within 21 days.

Pension sharing process following the court order

Once the courts have decided how much of the pension rights should be allocated to the ex-spouse/former civil partner, the pension sharing order will take effect from:

- The date on which the Decree Absolute of Divorce or nullity is pronounced or, if later
- 21 days from the date of this order, unless an appeal has been lodged in time, in which case the effective date of the order determining that appeal
- The option that applies should be specified on the Pension Sharing Order but is often not in practice

Once the pension provider/trustees receive a Pension Sharing Order they have three weeks from receipt to appeal against any order/agreement.

To process a pension sharing order, certain information will be needed from the ex-spouse/former civil partner together with copies of certain documentation relating to the divorce. In broad terms the details required are:

- The full name (and details of all previous names used by that person), date of birth and National Insurance Number for the ex-spouse/former civil partner
- A copy of the final pension sharing annex (Form P1 which contains the specific terms of the pension sharing order)
- A copy of the decree absolute. If the divorce took place in Scotland the provider will require the decree of divorce (or decree nisi) or the completion of Minutes of Agreement
- Confirmation there is no appeal pending on the pension sharing order
- If the pension credit is to be transferred, details of the receiving scheme

Once the scheme is in receipt of all the required documentation and any charges that are outstanding, they then have four months to implement the pension sharing order. This implementation period involves discharging the pension debit/credit by way of an internal or external transfer.

The scheme is obliged to carry out an up-to-date valuation as part of the implementation process.

The date on which this is carried out will be the **transfer day**, which will be the latest of the date of the decree absolute, **28 days** after the date upon which the pension sharing order is made, and any date specified by the court on which the pension sharing order is to be effective.

The new valuation often causes confusion because the CETV will almost certainly have changed since the initial valuation was carried out during the negotiation process. When the percentage share is calculated the value of each part will therefore be different from the amounts that were expected and the divorcing parties often perceive this to be a mistake.

Lifetime allowance considerations

Offsetting

Where the pension is being offset against other assets, meaning the benefits will remain wholly intact, the lifetime allowance (LTA) position should be unaffected.

Earmarking

The level of benefits under an earmarking order will be tested against the original policyholder's available lifetime allowance – not the ex-spouse's/former civil partner's. This will be done at the point the benefits are put into payment. As a result, this may be a less attractive option for those with substantial funds. As earmarked benefits are tested against the original policyholder's lifetime allowance, if the original policyholder turned out to be close to their lifetime allowance, it would be difficult to replace the lost pension benefits. If they exceed the lifetime allowance they may have to pay a lifetime allowance charge on benefits they will not receive, and will not be able to save more to cover the loss of benefits.

Pension sharing

Pension debits and credits have to be taken into account for the purposes of an individual's lifetime allowance (LTA). Any pension credit established on or after A-day (6 April 2006) – in respect of benefits that are not yet in payment – will count against the ex-spouse's/former civil partner's LTA, and not against the **member's** LTA.

Pensions in payment after A-day may reduce the member's pension benefit as a result of a pension debit as follows:

- If debited from the member's capped drawdown fund a recalculation of the maximum limit will be undertaken immediately, but the new maximum income limit will not apply until the next pension year, unless this is the start of a new reference period
- If debited from an annuity, the annuity will be reduced

However, where a pension credit is paid in respect of a member's pension already in payment, that started after 5 April 2006, the ex-spouse/former civil partner is entitled to claim to have their LTA enhanced because the pension will already have been tested against the member's lifetime allowance. This includes pension credits received from a pension in drawdown. It is known as a Lifetime Allowance Enhancement factor and is calculated according to the following formula:

$$\frac{\textbf{APC}}{\textbf{SLA}}$$

Where:

APC = annual pension credit – that is, the value of the pension credit at the time it was acquired

SLA = the standard lifetime allowance at the time the rights were acquired

In this circumstance, the LTA enhancement factor is called the pension credit factor which is then applied to the standard LTA[1] at any future benefit crystallisation events (BCEs) to provide the uplift to the individual for the purpose of that BCE.

As an example:

Joan receives a pension share of £50,000 in December 2016 from a pension already in drawdown by her ex-husband. The enhancement factor is 0.05 (£50,000/£1 million). If the individual is entitled to more than one enhancement factor, those factors are simply aggregated.

The application for an enhancement factor must be made to HMRC within five years of the 31 January following the end of the tax year in which the pension credit is received. It can be applied for using HMRC form APSS201.

The pension credit factor should not be confused with the **pre-commencement pension credit factor** which can be applied to pension sharing orders in existence on 5 April 2006. The deadline for those applications was 5 April 2009.

[1] If the pension credit rights were acquired between 6 April 2006 and 5 April 2012 and the relevant BCE is on or after 6 April 2012, the pension credit factor is applied to £1.8 million rather than the standard LTA. For pension credits acquired between 6 April 2012 and 5 April 2014 the pension credit factor is applied to £1.5 million, and between 6 April 2014 and 5 April 2016 the figure is £1.25 million. The SLA at the point of crystallisation by the recipient is used if it is higher and is also used for rights acquired after 6 April 2016. (Source: HMRC Pensions Tax Manual, section PTM095200.)

The LTA enhancement factor for a pre-commencement pension credit is calculated by dividing the value of the pension credit, indexed in line with RPI from the month it was acquired to April 2006 (IAPC), by the standard LTA for 2006/07 of £1.5 million (SLA).

If an individual is entitled to primary protection, he or she cannot become entitled to a pre-commencement pension credit factor, as those pension credit rights are already factored in to the primary protection factor.

A member, whose benefits have been reduced by a pension debit, can potentially make up the loss in respect of their allowance. However, caution should be exercised if the member has any form of transitional protection. This is explained in more detail below.

Special cases

Lifetime allowance protection

For the member who sees their pension reduce by the pension debit, there can be an impact on lifetime allowance protection.

Primary protection

Pension debits

The individual's Lifetime Allowance Enhancement Factor (LAEF) is recalculated to take into account the value of the benefits deducted under the pension debit. On incurring a pension debit, the individual must notify HMRC who will revise the calculation and issue a new certificate if protection has not been lost.

The calculation deducts the value of the pension debit enhancement factor. A reduced personal LTA then applies to all subsequent benefit crystallisation events.

The reduction of the rights (RR) takes place on the effective date of the order, defined by the Welfare Reform and Pensions Act 1999 as the 'transfer day'. (Not necessarily the same as the date the individual's rights are actually split.)

The formula for primary protection is:
(RR – SLA) / SLA

Where:

RR = value of individual's pension rights at 5 April 2006

SLA = £1.5 million

Example: Bob had £2 million of pension rights at 5 April 2006. This equated to a 0.34 factor [(£2 million – £1.5 million)/£1.5 million]. If a pension debit of £200,000 is made after A-day, the revised A-day value would be £1.8 million, and the factor would be 0.20 [(£2 million – £200,000 – £1.5 million)/£1.5 million].

If a pension debit reduces the RR to below £1.5 million, then primary protection will be lost meaning the individual will revert to the standard lifetime allowance, as the factor would be 0.

Pension credits

Primary protection is unaffected by pension credits.

Enhanced protection

Pension debits

The application of a pension debit to a member's account won't in itself affect the member's enhanced protection status. On the other hand, any contribution or benefit enhanced protection, will result in the loss of enhanced protection. Whether benefits can be rebuilt following a pension debit without losing the enhanced protection will depend on the type of the individual's arrangements.

Any contribution into a money purchase arrangement (that isn't a cash balance one), constitutes relevant benefit accrual, meaning protection would be lost.

If the member is in a defined benefit or cash balance 2006, they may be able to rebuild their pension rights without losing enhanced protection. This is because accrual is based on increase in benefits not actual contributions made.

As the relevant benefit accrual test for these arrangements isn't performed until a BCE or transfer takes place, it's only at that point – that is, when the appropriate limit is tested – when it is determined whether enhanced protection has been lost due to rebuilding pension debit rights. However there is a risk that when benefits come into payment they'll be more than the allowable amount and enhanced protection may be lost. See HMRC Pensions Tax Manual, section PTM092430, for further details on the relevant benefit accrual test.

Pension credits

If someone receives a pension credit for a pension sharing protection will depend on how the credit is received:

- If the pension credit is transferred into a new arrangement, the establishment of a new arrangement could trigger the loss of enhanced protection, unless the new arrangement is the same or another registered pension scheme is done in what are called 'permitted circumstances'
- If the pension credit is transferred into an existing money purchase arrangement, enhanced protection won't be lost, as this isn't a relevant contribution
- If the pension credit is transferred into an existing defined benefit or cash balance arrangement, enhanced protection may be lost at a later stage if relevant benefit accrual occurs

For individuals in an unfunded public sector scheme, receipt of a pension credit could cause an unpleasant prospect – his or her credit is not allowed to transfer out of the scheme (to a money purchase scheme) because of special restrictions on public sector schemes and a credit allocated to the existing scheme will be relevant benefit accrual.

Fixed protection 2012/2014/2016

Pension debits

A pension debit will not result in the member losing fixed protection and there is no requirement for the transfer to represent all of the member's benefits in the transferring arrangement. Provided that the other conditions are met, a partial transfer can be a permitted transfer, so that fixed protection 2012, 2014 or 2016 would not be lost.

However, in a similar way to enhanced protection, any attempt to restore the lost benefits by means of further contributions or benefit accrual would result in the loss of fixed protection.

Pension credits

The same conditions as for enhanced protection apply.

Individual protection 2014 or 2016

The individual's personalised LTA will be reduced to take into account the value of the benefits deducted under the pension debit if the transfer day (described below) occurs after 5 April 2014 for IP2014 and 6 April 2016 for IP2016.

In either case, their personalised LTA will either:

(a) be reduced by an amount related to the amount of the pension debit and, therefore, the individual will have a lower personalised LTA, or

(b) if the reduction would result in a figure of less than£1.25 million for IP2014 or £1 million for IP2016, protection would cease to apply and, therefore, the individual will revert to the standard LTA

In either case, the reduction in (a) will be 100% of the pension debit where the date of the pension debit is 2014 or between 6 April 2016 and 5 April 2017 for IP 2016 (referred to as 'the first year').

Where the date of the pension debit is not in the first year, the amount used to calculate the reduction in (a) is scaled down by 5% for each full year that has elapsed since the first day of the relevant first year. For this purpose, the date of the pension debit is the transfer day (that is, the date that the relevant order or provision takes effect).

To help explain, here is an example provided by HMRC in their Pensions Tax Manual, section PTM094400:

> Julie has IP 2014. The value of her pension savings on 5 April 2014was £1.8 million. This is her relevant amount. As Julie's relevant amount exceeds £1.5 million, her protected lifetime allowance for IP 2014 is £1.5 million.
>
> In March 2015, she crystallises benefits worth £1.4 million relying on IP 2014 to prevent a lifetime allowance charge arising as the **standard lifetime allowance** at that time is £1.25 million. This uses up 93.33% of Julie's protected lifetime allowance. So she has an unused lifetime allowance of 6.67%.
>
> In December 2020, the value of Julie's remaining pension rights have risen to £600,000 but are reduced by a **pension debit** of £400,000 as a result of a pension sharing order with a transfer date of 15 August 2020. This leaves her with £200,000 of pension rights.
>
> By 15 August 2020, six complete tax years have passed since tax year 2013-14. So the pension debit that is applied to her relevant amount is reduced by 30% to £280,000. Julie's £1.8 million relevant amount is therefore reduced to £1.52 million because of the reduced £280,000 pension debit.
>
> Her protected lifetime allowance therefore remains at £1.5 million. Julie crystallises her remaining £200,000 pension rights in March 2021 when the standard lifetime allowance is still £1.25 million.
>
> She has 6.67% remaining lifetime allowance available. Applying this percentage to her protected lifetime allowance of £1.5 million produces an amount of £100,050 as her available lifetime allowance. Julie is therefore subject to a lifetime allowance charge on £99,950.

On incurring a pension debit, the individual must notify HMRC who will revise the calculation and issue a new certificate if protection has not been lost. HMRC must be notified within 60 days of the date of the pension debit for this purpose. If a new certificate is issued, the lower personalised LTA will be effective from the date of the pension debit. Any BCE that has occurred before the date of the pension debit will be unaffected. In other words, the revised personalised LTA does not apply retrospectively so benefits in excess of the lifetime allowance, but already taken under the protection of IP2014 or IP 2016, will not now be subject to a lifetime allowance charge.

Summary

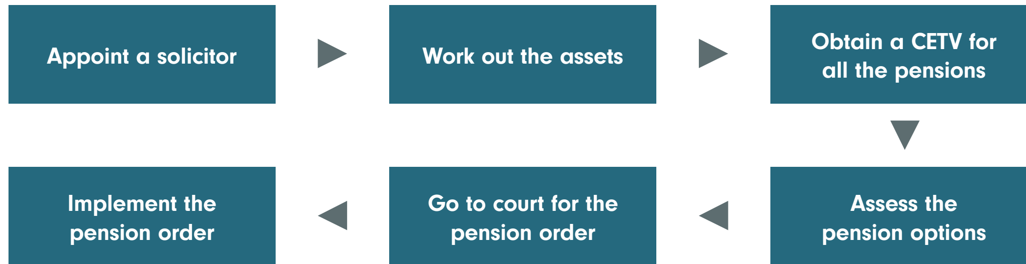
In many cases, 'pension wealth' can be greater than 'property wealth' or other assets, but as you can see within this guide, it is a complex area. It is no surprise that it forms a crucial part of divorce settlements and therefore getting the correct advice is essential.

To recap:

There are three methods in which pension assets may be accounted for in the divorce process:

- **Pension offsetting** – an equivalently valued non-pension asset is given over to the non-pension owning ex-spouse/former civil partner, that is, an offsetting capital sum
- **Pension earmarking** – provides an ex-spouse/former civil partner with a share of a pension scheme member's pension rights on divorce – the ex-spouse's/former civil partner's share is paid when the member draws benefits. This is now called attachment
- **Pension sharing** – splits the pension arrangements with the pension share expressed as a percentage of the CETV. Upon the split a pension debit and a pension credit results:
  - **Pension debit** – the amount of benefit rights given up by a member and allocated to the member's ex-spouse/former civil partner when a pension sharing order is made in respect of that member
  - **Pension credit** – the amount of benefit rights directly or indirectly attributable to the ex-spouse/former civil partner when the pension sharing order is made

Procedurally



You can help with many aspects of a divorce financial settlement. From a pension perspective this can include the initial evaluation of the value of pension benefits – that is, a defined benefit scheme may benefit from favourable discretionary increases, and a defined contribution scheme may have specific policy terms such as guaranteed annuity rates, exit charges and so on. You can also assist with assessing which option is best regarding offsetting, earmarking or sharing, with a view to achieving equality of income following the divorce, and considering implications on any LTA protection. Finally you can provide advice with regard to rebuilding benefits for retirement.

Important information

The suitability of various options for pensions on divorce will depend on the particular circumstances of each individual. Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning, as well as different legal impacts on the distribution of assets on divorce.

This document provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations. This is a complicated area, and individuals going through a divorce should take tailored, appropriate advice about their financial settlement on divorce and future tax and financial planning.

This document represents a summary of our understanding of the law at the date of its last review (August 2018). Tax limits, allowances and rules are often subject to change and may change in future. Individuals should check that tax limits, allowances and rules have not changed.

3. Pension death benefits – defined benefit schemes

Although death benefits under defined benefit schemes have largely remained unchanged as part of the pension freedom rules, introduced in April 2015, there have been some key changes in how they are taxed. Below we look at the type of death benefits payable and the tax implications under the defined benefits schemes.

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Potential beneficiaries 41

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Taxation – member's death age 75 or older 42

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Types of benefit

Lump sums

- A defined benefits lump sum death benefit is typically (but not necessarily) a multiple of salary for those in employment. Member contributions may also be returned on death.
- A pension protection lump sum death benefit may be available when a scheme pension is being paid (see opposite).
- A trivial commutation lump sum death benefit may be paid when the value of a dependants' pension or remaining guaranteed instalments of the pension is no more than £30,000.

Pension

- Dependants' scheme pensions can be paid on the death of a scheme member before or after retirement. Depending on scheme rules they can be deferred for a period, payable for a limited time, reduce in payment or be paid less frequently than annually. However, upon the dependants' death they cannot have a guaranteed period, pension protection, be accompanied by a pension commencement lump sum or have a further pension payable.

Death in service

Often the lump sum death benefit is a multiple of salary (for example, 4 times). In addition, a pension may be payable to a spouse, civil partner or (depending on scheme rules) another dependant, which is normally a fraction (for example, half or two-thirds) of the member's pension based on potential service to normal retirement date. Many schemes offer a smaller pension for dependent children in addition.

However, there is no legislative maximum for either the lump sum or pension.

Death in deferment

A lump sum death benefit is unlikely to be available to those who no longer work for the sponsoring company (or cease to be a member of the pension scheme), but pensions for dependants are likely to be on the same basis as for active members.

Death in retirement

On death after a pension has started to be paid, one or more dependants' pensions may be paid. There is no maximum level of such pensions under age 75, but on death after age 75 the total of dependants' pensions must not exceed the pension payable to the member at the time of death.

Alternatively, or in addition, the pension may be guaranteed to be paid for a period of up to 10 years, even if the member dies in that period, or a pension protection lump sum may be paid with a maximum of 20 times the initial level of pension, minus the total of pension paid before death.

Dependants' pensions and pensions paid during guaranteed periods cannot be commuted except on the grounds of triviality (if the value is under £30,000).

It is possible, but not common, for a defined benefits lump sum death benefit to be paid when a pension is in payment.

Potential beneficiaries

There are no legislative restrictions on recipients of lump sum death benefits, though scheme rules may contain restrictions. Recipients are at the discretion of the scheme trustees, but the member may make a non-binding expression of wish. This could be that benefits are paid into a trust set up by the member, but the trustees are not bound to follow that wish.

Dependants' pensions can be paid to spouses and registered civil partners, and also to those who were financially dependent on or inter-dependent with the member at the time of death, or were dependent because of physical or mental impairment. Children under age 23 also qualify as dependants. What dependants' pensions are available will be specified in the scheme rules.

Taxation – member's death before age 75

Assuming that the scheme trustees have discretion over beneficiaries, all benefits payable should be free of inheritance tax regardless of the age of the member on death. However, they may be subject to income tax.

Lump sums

Defined benefits lump sum death benefits payable following the member's death under age 75 are free of tax, as long as they are within the lifetime allowance and are paid within two years of the date when the scheme administrator first knew of the member's death (or could reasonably be expected to have known).

A defined benefits lump sum death benefit is a benefit crystallisation event (BCE 7). If, when added to any previous crystallisation events, it exceeds the lifetime allowance, the excess is taxable at a rate of 55%. Where the two year period is exceeded, the lump sum is treated as taxable income for the recipient.

A pension protection lump sum death benefit is not a BCE, but the two year limit does not apply.

Trivial commutation lump sum death benefits are taxable as income for the recipient and are not benefit crystallisation events.

Pension

Dependants' scheme pensions are taxable as income for the recipient. They are not tested against the lifetime allowance.

Taxation – member's death age 75 or older

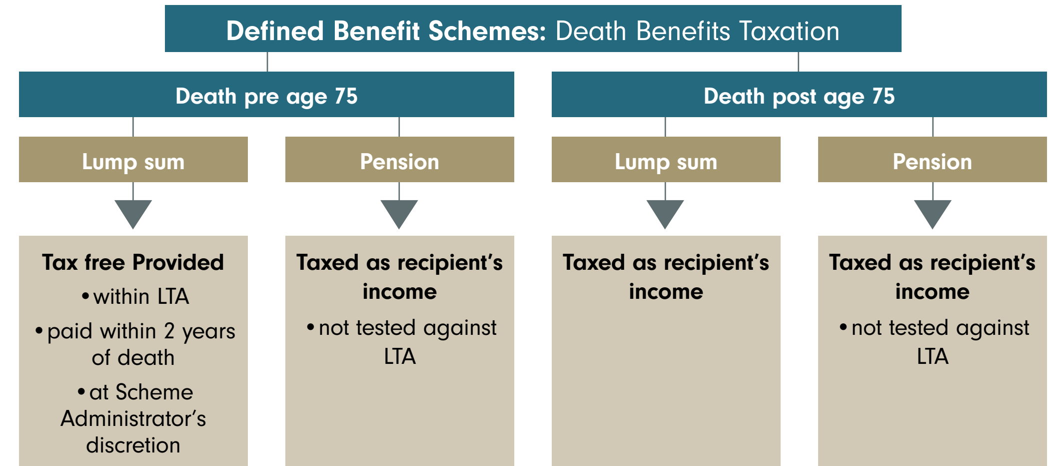
Lump sums

Defined benefit lump sum death benefits and pension protection lump sum death benefits are taxable as income for the recipient. Trivial commutation lump sum death benefits are taxable as income for the recipient.

There is no test against the lifetime allowance.

Pension

Dependants' scheme pensions are taxable as income for the recipient. They are not tested against the lifetime allowance.



Pension freedom rules and defined benefit pension death benefits

The pension freedom rules implemented in April 2015 mean that most death benefits (regardless of the form of the benefit paid) from money purchase arrangements are tax-free where the member dies under age 75 and funds are within the members remaining lifetime allowance. However, this was not extended to defined benefit schemes meaning dependants' pensions remain taxable regardless of the age on death.

The main changes for defined benefit pensions are:

- Pension protection lump sum death benefits are no longer taxable under age 75 (previously there was a 55% charge); and
- The rate of tax on lump sum death benefits paid on a member's death age 75 or over and when the two year limit is exceeded in respect of benefits payable following a member's death under age 75 reduced from 55% to 45% from 6 April 2015, and changed again on 6 April 2016 so that the payment is treated as taxable income for the recipient.

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4. Pension death benefits – money purchase schemes

The pension freedom rules introduced in April 2015, standardised the death benefit treatment for the different money purchase retirement options. Below we look at the type of death benefits payable and the tax implications under money purchase schemes.

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Beneficiaries 44

Income tax treatment of benefits paid following the death of the member under age 75 44

Income tax treatment on death age 75 and over 45

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Inheritance tax treatment 45

Expressions of wish 46

Types of benefit

Lump sums

- An uncrystallised funds lump sum death benefit can be paid from funds from which the member has not yet taken benefits.
- A flexi-access drawdown fund lump sum death benefit may be paid on the death of a member, dependant, nominee or successor while in flexi-access drawdown. Drawdown may be paid wholly or partly as a short-term annuity.
- A drawdown pension fund lump sum death benefit may be paid on the death of a member or dependant while in capped drawdown.
- A charity lump sum death benefit may be paid on the death of a member or beneficiary in drawdown or a member with uncrystallised benefits, but only if there are no surviving dependants of the member.
- An annuity protection lump sum death benefit may be available when an annuity is being paid. The maximum amount is the
  purchase price of the annuity, minus the total of annuity payments made to the member.
- A trivial commutation lump sum death benefit may be paid for pensions already in payment, when the value of a dependant's pension or remaining guaranteed instalments of the pension is no more than £30,000.
- Members of money purchase arrangements may also be provided with pension lump sum death benefits by their employers (for example, a multiple of salary) or may have a pension term assurance arrangement, for which tax relief is available if it started before 6 December 2006.

Pensions

- A beneficiary's annuity (or scheme pension paid in the form of an annuity), may be payable on the death of a member. This can be an annuity bought alongside the members' annuity and payable on their death or an annuity bought with the remaining uncrystallised or drawdown funds.
- Instalments of an annuity may continue until the end of a guaranteed period selected when the annuity was bought. There is no maximum length of a guaranteed period.
- A beneficiary's flexi-access drawdown may be set up for a dependant, nominee or successor.

Beneficiaries

Beneficiaries on the member's death in a money purchase arrangement can be:

- Dependants of the member.
- Nominees of the member or scheme administrator.
- Successors, where benefits on the death of the member or a previous beneficiary are in the form of flexi-access drawdown and the current beneficiary dies.

To maintain beneficial inheritance tax treatment, the scheme administrator must retain some discretion in the selection of beneficiaries – see page 44.

Income tax treatment of benefits paid following the death of the member under age 75

Uncrystallised funds

Money purchase death benefits payable from uncrystallised funds are free of tax, as long as they are within the lifetime allowance (LTA) (where a member dies before age 75) and are paid (or a beneficiary's annuity or drawdown established) within the relevant two-year period. This is, within two years of the date when the scheme administrator first knew of the member's death (or could reasonably be expected to have known).

Payment or setting up of benefits on death under age 75 is a benefit crystallisation event, whether the benefits are lump sum (BCE 7), flexi-access drawdown (BCE 5C) or annuity (BCE 5D). If, when added to any previous crystallisation events, benefits exceed the lifetime allowance, the excess is taxable at a rate of 55% for BCE7 and 25% for BCE 5C and 5D.

Where the two year period is exceeded, a lump sum is treated as taxable income for the recipient. Drawdown or annuity payments are treated as taxable income of the recipient.

Crystallised funds

If the scheme member is under age 75 and dies while in drawdown or receiving an annuity, the benefits paid are free of income tax whether paid as a lump sum or as income (drawdown/annuity). The requirement for the benefits to be paid (or a beneficiary's annuity or drawdown established) within two years of the date of when the scheme administrator first knew of the member's death (or could reasonably be expected to have known) applies equally here.

The exception to benefits being paid free of tax is where a trivial commutation lump sum death benefit is paid.

In this case, the whole lump sum is taxable as pension income of the dependant or individual entitled to receive it.

If a beneficiary (dependant/nominee/successor) subsequently dies under age 75 while in drawdown, the benefits paid to their successors are free of income tax. Note that it is the beneficiary's age at death that is the determinant, not the age at death of the original member.

Any benefits paid in the form of flexi-access drawdown to dependent/beneficiary/nominee or their subsequent successors will have been tested against the original member's LTA when they were accessed and will not therefore be included in the recipient's benefits for LTA purposes.

There is no LTA test on death in drawdown or annuity.

Income tax treatment on death age 75 and over

Lump sums

Where the member or beneficiary entitled to benefit dies above age 75, whether the pension is uncrystallised, drawdown or annuity, any lump sum paid is taxed as income of the recipient. The exception is where a charity lump sum death benefit is being paid (see below).

Charity Lump Sum Death Benefits

This is a lump sum that can be paid to a charity on the member or dependants' death. However, in order for a payment to be made in this way, the member must have no dependants and the member/nominee or successor must have nominated a charity before their death.

Payment of charity lump sum death arising after 16 September 2016 can be paid from crystallised funds or uncrystallised funds irrespective of the members age. The payment is free of tax.

A charity lump sum death benefit is not a benefit crystallisation event so its payment does not trigger a lifetime allowance test nor does it use up any of either the deceased member's or deceased beneficiary's lifetime allowance.

Pension

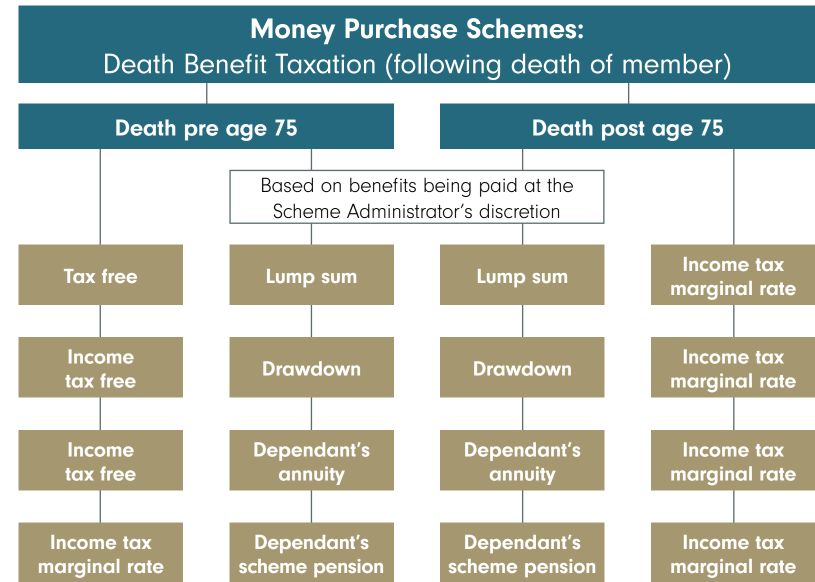
If benefits are received, whether drawdown or annuity, withdrawals or income paid to the recipient are taxable as income where the member or previous beneficiary dies age 75 or over.

There is no LTA test on death after age 75.

Inheritance tax treatment

For most money purchase schemes, death benefits should be free of inheritance tax if the scheme administrator has discretion over the beneficiaries.

An inheritance tax charge could arise under any form of pension if the member is deemed (by HMRC) to have transferred value out of the estate. Particular regard should be made to contributions and transfers made late in life or whilst in ill health. This is a complex and arguably contentious area of law and careful regard should be made to HMRC guidance manuals.



Exceptions:

- Trivial commutation lump sum death benefits are always taxable as pension income
- Charity lump sum death benefits are always paid free of tax

Expressions of wish

Where the scheme administrator has discretion over beneficiaries, the member can submit a non-binding expression of wish nominating who they wish to be considered to receive benefits. The scheme administrator will take the expression of wish into account when exercising discretion.

It is important that it is kept up-to-date, especially if the member's circumstances or preferences in relation to who should receive benefits change.

It may be possible for a member to submit a binding expression of wish nominating who they wish to be considered to receive benefits, however the pension benefits payable would be deemed by HMRC to fall within that members estate in accordance with IHTA 1984/S5(2).

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Information is correct as at June 2018.

5. Pension withdrawals and how they are taxed

When it comes to making withdrawals directly from a pension, you will know this can be done in many different ways. What may be less clear however, is how the tax is calculated and paid. A key aspect when advising on pension withdrawals is to consider the tax position of the client, so as to determine just how much to withdraw to achieve the net amount required. However, as the withdrawal could be taxed in a number of different ways, this can make it very difficult to determine before the withdrawal is made. To help with this, we've created this factsheet which covers the main points.

Here we explain how the tax on a flexible pension withdrawal is administered initially by a pension provider. It also outlines the process for reclaiming any overpaid tax due as a result of the flexible pension payment.

Please note that the information within this guide is correct as at 6 April 2018. These examples are based on the tax rules in force for the tax year 2018/19. The amount your clients withdraw and the tax they may pay will be entirely dependent on their individual circumstances and pension providers have to tax pension payments for Scottish Residents using the Scottish Income Tax rates.

Tax rates are subject to change in future. FundsNetwork cannot give advice regarding tax effects and will not accept responsibility for any loss occurring from their use.

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Ongoing income and tax codes 49

Dealing with overpayments or underpayments of tax 52

Operation of PAYE 48

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Taxation on pension withdrawals

Taxable pension income, however derived, is taxed as 'Earned Income'. This includes, but is not limited to, payments from lifetime annuities, scheme pensions, drawdown arrangements and Uncrystallised Funds Pension Lump Sum (UFPLS).

This means that the body making payment of the income must operate the taxation of the payments on a Pay As You Earn (PAYE) basis, much in the same way an employee would be taxed by their employer. This means the body paying the pension benefits will pay out the income, net of tax, based on a tax code as instructed by HMRC.

Operation of PAYE

It is important to note that HMRC have specified that flexibly accessed payments are not to be treated as annual payments (i.e. month 12 basis).

Income payments from a pension scheme are taxed at source, at the relevant rate.

The amount of tax that is calculated and deducted will depend on whether it is the first taxable withdrawal the customer is making from their pension and whether the pension provider has been provided with a tax code.

This principle applies equally to withdrawals/pension income being set up on a regular payment basis and to one-off lump sum withdrawals.

All flexibly accessed pension withdrawals that are taxable (i.e. more than the tax-free part) should initially be set up and taxed on a "month 1" basis. The code that is applied to any taxable withdrawals will then be different depending on whether the provider is in possession of a tax code for the current tax year or not.

If the pension provider does hold a current tax code or P45 for the person making the withdrawal, they can apply the relevant tax code on a month 1 basis and deduct the appropriate amount of tax from the pension payments as they are made. A typical example of this is where an individual has just stopped working and then accesses their pension through their existing workplace pension.

Another example of this could be where a customer is already receiving regular pension payments from that provider and the individual is setting up ad-hoc withdrawals from an additional account.

If the member is unable to provide a P45 from the current tax year, or in scenarios where the pension provider does not already hold a P45 or an up-to-date tax code from HMRC as a result of previous withdrawals from that pension plan, the pension provider will set up the initial income on an emergency tax code, generally month 1 (M1) basis.

If the pension withdrawal that is made extinguishes the pension pot, the provider will send a P45 form to the individual account holder. This will set out how much tax has been deducted by the provider in the tax year in question.

If the initial payment does not extinguish the individual's fund, the pension provider will simultaneously request a tax code from HMRC when they make the pension payment. HMRC will then generally issue the provider with the relevant tax code to be applied to any subsequent payments. A P60 will then be issued to the individual after the end of the tax year detailing the total amount of payments and tax paid during the whole tax year. Annual P60 statements issued to Scottish Residents should show the 'S' prefix tax code along with the total tax deducted.

How does it work?

An 'emergency month 1' tax code essentially means any income is tested against 1/12th of the personal allowance, 1/12th of the basic-rate tax band, 1/12th of the higher-rate tax band and at the additional (45%) rate for amounts above those bands, as applicable. The amount being withdrawn is treated as if it will continue to be paid each month for tax purposes. This means the tax is based on that specific payment only, not the individuals income over the whole year. These codes are sometimes referred to as 'non-cumulative'.

The provider will therefore apply 1/12th of the personal allowance (1/12 of £11,850 in 2018/19) to the payment, and will assess the remaining payment against 1/12th of each of the income tax bands currently in force. The table on the following page shows the taxation of income payments where an emergency month 1 tax code applies.

Tax Band	Tax Rate	Annual Tax Band Amounts	Month 1 (1/12) position on payments
Personal Allowance	**0%**	**£11,850**	**£987.50**
Basic Rate	**20%**	**£34,500**	**£2,875.00**
Higher Rate	**40%**	**£34,501 - £150,000**	**£9,624.92**
Additional Rate	**45%**	**OVER £150,000**	**EXCESS**

The calculation method for taxing any flexible pension payments made to Scottish Resident taxpayers using an emergency tax code, is unaffected by the Scottish Income Tax changes for the 2018/19 tax year. This means the process and tax payable by UK and Scottish taxpayers where an emergency tax code is to be operated, will be the same and in accordance with the table above.

Ongoing income and tax codes

After the first flexibly accessed pension withdrawal has been taxed and paid out by a provider, subsequent withdrawals will usually be taxed under PAYE using the relevant tax code as received through from HMRC. Tax codes contain information about an individual's tax situation and explain how much tax-free personal allowance is available for the purposes of making the pension payments.

Although there are a lot of tax codes that HMRC could issue. The general principles are quite straightforward. They normally encompass a number followed by a letter, a letter on its own or a prefix letter followed by the number.

- A number tells the employer or pension provider how much personal tax-free allowance an individual has available for the purposes of taxing the income.
- Letters describe the situation and how it affects their personal allowance.

For example, if an individual is entitled to the full personal allowance of £11,850 for the 2018/19 tax year, HMRC will divide this by 10 and issue a tax code of 1185L. The L confirms the individual is entitled to the standard tax-free personal allowance.

Every individual's personal financial circumstances are different, so not everyone has the same tax code or standard personal allowance. Many individuals receive taxable income from a variety of sources, which could include dividends, rental income, other taxable employment benefits etc. HMRC takes all these sources of income and allowances into account to arrive at an individual's tax code.

Below are some of the common codes that HMRC may issue:

Code	What it means
L	The standard tax-free personal allowance is available (£11,850 in 2018/19 tax year)
M	Marriage allowance: confirms an individual has received a transfer of 10% of their partner's personal allowance
N	Marriage allowance: confirms an individual has transferred 10% of their personal allowance to their partner
S	An individual will be taxed using Scottish Income Tax rates
T	Includes other calculations to work out the individuals personal allowance (For example, it may have been reduced because their estimated annual income is more than £100,000)
K	Deductions have exceeded the individual's personal allowance. The number in the code after the K is multiplied by 10 and added to their pay (in other words, K500 means the individuals personal allowance is -£5,000)
NT	No tax is to be taken from the income or pension payments
BR	All pay is to be taxed at the basic rate (20%), with no personal allowance. An S before the code indicates all pay is to be taxed at the Scottish basic rate (20%)
D0	All pay is to be taxed at the higher rate (40%), with no personal allowance. An S before the code indicates all pay is to be taxed at the Scottish intermediate rate (21%)
D1	All pay is to be taxed at the additional rate (45%), with no personal allowance. An S before the code indicates all pay is to be taxed at the Scottish higher rate (41%)
0T	No personal allowance is available. All income is to be taxed at the basic (20%), then higher (40%), then additional rate (45%) accordingly. For Scottish rate tax payers, all income is to be taxed at the starter (19%), then basic (20%), intermediate (21%), higher (41%), then top rate (46%) accordingly
W1/M1	An emergency tax code providing 1/12th of all tax bands including the personal allowance

Tax matters can be complex and everyone's tax position is different. Tax codes are supplied to providers by HMRC. If tax is being deducted based on an incorrect tax code HMRC should be contacted first as the provider is not authorised to alter this unless they receive a revised code from HMRC.

Examples

EXAMPLE 1

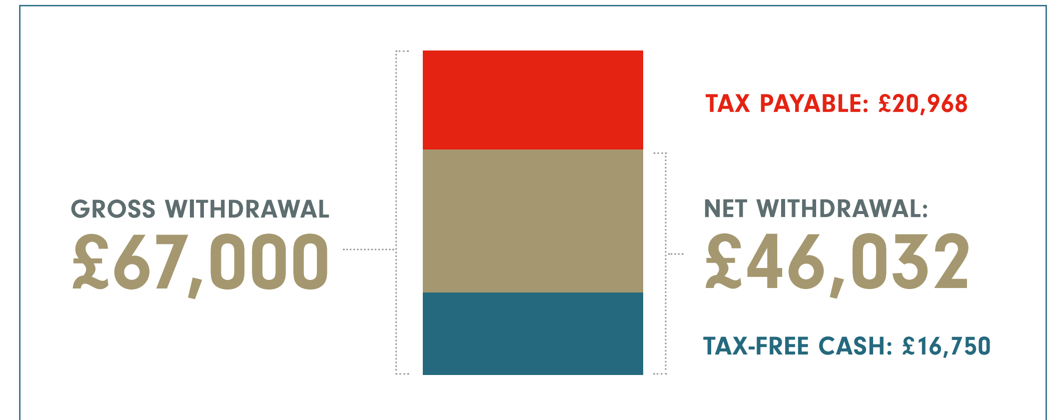
Tara, who will have earnings of £30,000 in the 2017/2018 tax year as she reduces her working hours, decides to take an Uncrystallised Funds Pension Lump Sum (UFPLS) in May 2017 from her pension totalling £67,000 to top up her income for the year. Assuming the provider is not already in possession of Tara's tax code, a taxable payment of £50,250 (after the 25% tax free cash is deducted) will be taxed on an emergency month 1 tax code basis as follows:

Tax Band	Annual Tax Band	Month 1	Tax rate	Tax due
Personal Allowance	Up to £11,850	£987.50	0%	£0
Basic Rate	Next £34,500	£2,875	20%	£575.00
Higher Rate	Next £115,500	£9,624.92	40%	£3,849.97
Additional Rate	Over £150,000	£36,762.58	45%	£16,543.16

Payment amount =	£67,000.00
Total taxable amount =	£50,250.00
Total tax deducted =	£20,968.13
Net amount =	£29,281.87
Plus Tax-Free Cash =	£16,750.00
Net payment made =	**£46,031.87**

Subject to any rounding applied, the figures shown above may not be exactly the same as might appear in practice.

The graphic below provides a summary of the end result for the individual:



In many situations like this, the individual could be due a tax rebate. However, this will depend on their overall level of taxable income over the tax year. In example 1, based on Tara's earnings from her employment totalling £30,000 for the year, Tara could be due a tax refund of around £4,138.13 for the 2018/19 tax year subject to any other income she is in receipt of. It's important to bear in mind that where the individual has continuing employment or pensionable income, HMRC will typically issue a revised tax code to the bodies making those payments, which should result in any overpaid tax being reconciled by the end of the tax year.

The point at which this typically changes and instead of being due a tax rebate, the individual may have additional tax to pay, is where the pension withdrawal, when combined with their total income for the year, exceeds the personal allowance income limit of £100,000. Income above this limit reduces the personal allowance by £1 for every £2 over. As the personal allowance reduces, more tax is payable at 40%/45%, and therefore the total amount of tax payable for the year may be more than the total amount of tax paid, despite the application of the emergency tax code to the pension withdrawal.

EXAMPLE 2

If Anton had earnings for the 2018/19 tax year of £150,000 and also took an UFPLS payment of £67,000 in that tax year, he could actually have an additional tax bill of approximately £1,644 to pay at the end of the 2018/19 tax year, subject to any other taxable income he may have for the year. However, in practice, depending on proximity of the UFPLS to tax year end and whether Anton has any ongoing income, through the operation of PAYE, this may already be accounted for and paid during the tax year without any additional sum being payable at the end of the tax year by Anton.

EXAMPLE 3

Stuart receives income from a final salary pension scheme of £10,000 per annum and is also in receipt of a State Pension that pays him £8,500 a year in the 2018/19 tax year. Early in the tax year he withdraws £7,000 from his crystallised drawdown account. At that time, £1,830.00 of tax was deducted and paid to HMRC by his provider using an M1 emergency tax code. He intends to make a second withdrawal of £1,500 from the same account in March of the 2018/19 tax year. The provider has been sent a basic rate cumulative tax code from HMRC which will be applied to future payments.

As it's cumulative there are two factors to be aware of:

- Firstly, the need to account for the cumulative gross income in the tax year and the tax already paid
- Secondly, the code will generally apply for the proportion of the tax year the payment is being made in

In this scenario, as the payment is being made on a basic-rate tax code, no allowance/bands apply. The second payment will therefore be taxed as follows:

Gross taxable pay from provider =	£8,500 (£7,000 + £1,500)
Total tax paid on first withdrawal =	£1,830
Total taxable pay taxed at Basic Rate =	£1,700 (£8,500 X 20%)
Total refund due on second withdrawal =	£130.00 (£1,830 - £1,700)
Net amount received (including tax refund) =	£1,630 (£1,500 + £130)

In principle, if the cumulative tax due is less than the tax already paid, then tax should be refunded (as on a cumulative basis, too much tax has been deducted to that point). It is important to bear in mind that even if tax is refunded at this point, further tax could be refunded or even be deducted on subsequent withdrawals, depending on the tax code or at the end of the tax year when the individual's tax affairs are reviewed by HMRC.

These examples are based on UK Income Tax rates and may be different if Scottish Income Tax Rates are used.

Dealing with overpayments or underpayments of tax

In many cases, where an emergency tax code has been operated, the individual making the withdrawal may end up being due a tax refund or having to pay further tax.

The method for claiming any tax back or paying further tax will depend on the person's circumstances – for instance, on their overall tax position for the year and if they have extinguished their pension fund.

Ongoing income

Where a regular income has been set up, any over or under payment of income tax is usually accounted for through the PAYE process. This is done through application of an adjustment to the individual's tax code by HMRC which corrects the individual's tax position. However, where income payments are set up with close proximity to tax-year end, there may not be enough time for the tax to be reconciled.

Where more than one income payment has been made but an overpayment or underpayment has still occurred, depending on the individuals circumstances this could be dealt with in one of three ways.

1. The individual could wait until the end of tax year when HMRC will reconcile their account and make any repayment owed as part of its normal PAYE process. If, as part of that process, it is identified that a rebate is due or tax is owed, a P800 tax calculation will be posted to the individual. These will usually reach the individual by the end of November following the tax-year end.

   If a rebate is due:

   - The P800 the individual receives will notify them of the amount and whether they can claim their refund online. If the individual doesn't claim their refund online within 45 days, HMRC will send them a cheque. Individuals can also contact HMRC to request a cheque. If the P800 says HMRC will send the individual a cheque, the individual will usually receive it within 14 days.

   If tax is owed:

   The P800 the individual received will notify them of the amount owed. HMRC will usually collect this automatically in instalments over the course of the tax year following the end of the calculation. If HMRC are unable to collect the money in this way they will write to the individual. The P800 will also indicate if the money owed can be settled online or by cheque.

   Individuals will not receive a P800 if they are registered for self-assessment.

2. Alternatively, if the individual usually completes an annual self-assessment tax return, because they have income from other sources such as rental or self-employed income for instance, they can submit the details on their annual tax return. The individuals tax bill will then be adjusted accordingly.

3. If the individual does not normally complete an annual self-assessment tax return and they have not received a P800, individuals can contact HMRC directly if they believe their tax to be incorrect. HMRC will then assess the information they have received and issue a P800 if their re-assessment indicates the individual has over or under paid tax.

Lump sums and ad-hoc withdrawals

Where a lump sum has been withdrawn from the pension and there is no ongoing income against which any additional tax paid can be offset, the individual can either use the options above or if they want to reclaim during the tax year in question, they can use one of three forms available which are explained below.

- **P50Z** - should be used if the individual has extinguished their whole pension fund and has no continuing source of income (other than the State Pension)
- **P53Z** - should be used if the individual has extinguished their whole pension fund but does have a continuing source of income, for example, employment or other pension income
- **P55** - should be used if the individual has flexibly accessed some of their pension pot, but are not taking regular payments and the pension provider is unable to refund them

To claim in this way, applications can either be made online via the Government Gateway service or posted. Individuals will need to submit their completed form along with parts 2 and 3 of all the P45 forms they have received for any flexibly accessed pension withdrawals.

It is important to remember that these forms can only be used for reclaiming tax on pension flexibility payments.

HMRC have indicated they operate a 30 day turnaround (from the date the information is received by them) to process these forms.

Individuals, who use the standard P50 and P53 forms to request in-year repayments, where a pension flexibility payment has been taken, do not fall within the priority 30 day processing deadline. To avoid unnecessary delays individuals should **take care to ensure they are using the correct versions of the forms** and ensure they are fully completed.

HMRC can also make payment to the individual's own or a nominee's bank or building society account.

Please note: they will only pay this into an account held in the name of the individual to whom payment is due or in the name of the nominee.

Small pension fund lump sums

This is where the total value of the pension arrangement is below £10,000 and payment is made under the 'small pots rule'. These are taxed slightly differently in that the body making the payment always apply a basic-rate (BR) tax code to the payment. The result then is that generally 25% of the payment will be tax-free and the remainder (usually 75%) will be taxed at 20% (based on current rates). Small pots payments will also still be made using the UK basic-rate of Income Tax for Scottish Resident taxpayers.

Where the total value of the fund was above £10,000 but the residual fund (after any protected tax free cash has been paid), is below £10,000, the whole residual balance is treated as a special kind of trivial lump sum and taxable normally under PAYE.

Where the individual wants to reclaim overpaid tax as a result of a small pension fund lump sum, they can do so using the following form:

- **P53** - should be used if the individual has trivially commuted a pension fund (from April 2015 this only applies to Defined Benefit schemes such as Final Salary or Career Average) or withdrawn under the small pots rule

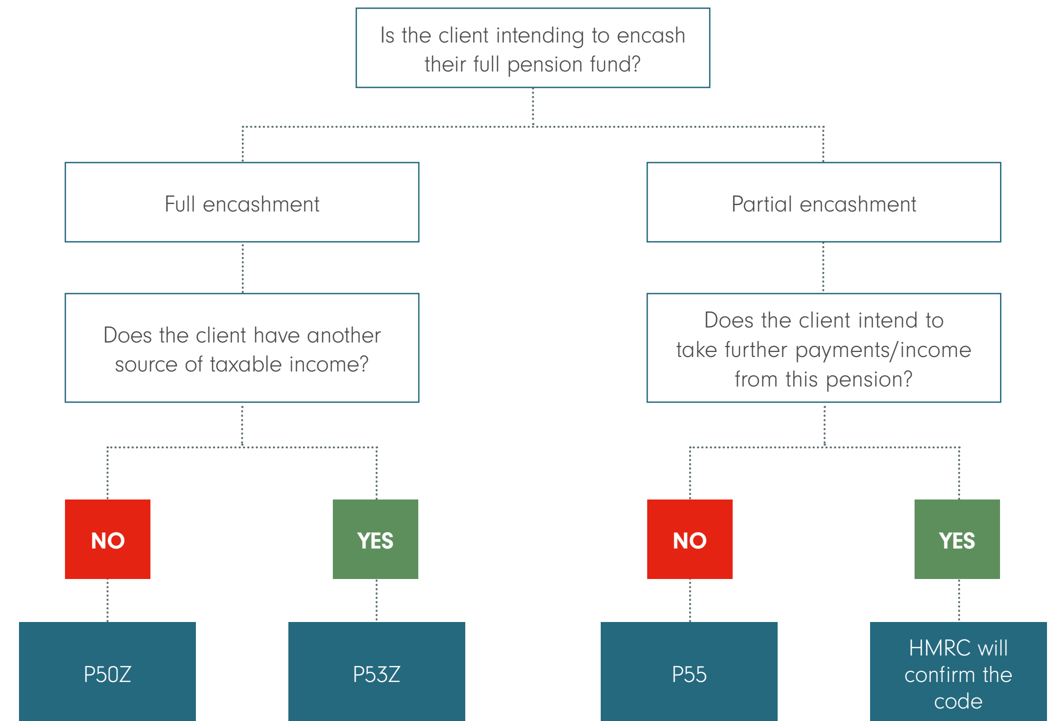
Claims can be made via the Government Gateway or posted. This form should not be used to reclaim overpaid tax for pension flexibility payments. The forms above should be used for that purpose.

Summary

On payment of a first withdrawal from a pension arrangement, the body making the payment will either apply the relevant tax code if they have it or apply an emergency tax code, month 1. If the payment is made on an emergency tax code basis, this could result in tax being overpaid. If tax is overpaid then the individual has a number of options:

- The individual could wait until the end of the tax year for HMRC to reconcile their account and make any repayments due. Alternatively they could submit information to their tax office or submit a tax return. Remember, if they have ongoing income for the year, HMRC will update their tax code and this could correct any initial overpayment of tax resulting from any pension withdrawals
- If they would prefer not to wait until the end of the tax year, they can submit a claim using one of the forms available. See the diagram below for details.

Tax repayment options for flexible pension withdrawals



Beneficiaries wanting to claim back overpayments of tax deducted on lump sum death benefits taxed using an emergency code should use the same version number of the forms as indicated above but with a (DB) suffix.

6. Facilitating the payment of adviser fees from a client's personal pension

When paying an adviser fee, the client often has two choices: pay the adviser firm direct (e.g. by cheque) or instruct a provider to facilitate the payment of the adviser fee. Facilitation is payment of the fee, on behalf of the client, through the provider and can take various forms:

- selling all or part of the client's investment product to pay the fee
- disposing of or reducing all or part of the client's rights under the investment product to pay the fee
- separating out an amount received from the client for fee payment from the amount to be invested
- paying the fee from a client's cash account

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FundsNetwork

For the purposes of this chapter, I shall use the term facilitation to mean a situation where the client's fee is paid by selling or disposing of their underlying investment product, as opposed to simple payment from a cash account or payment before an investment is made. Sometimes, selling or disposing the investment to meet a fee can bring tax disadvantage compared to paying direct. It might create a tax bill or use up part of a valuable tax allowance that the client might otherwise wish to utilise. In the past, advisers were generally remunerated by commission which had the advantage of normally keeping things outside the client's own tax affairs. Nowadays, cashing-in the investment to meet an adviser fee is often no different to cashing-in for any other purpose and the same tax consequences flow. There may also be tax disadvantage in taking fees from a particular product. Take an ISA... an exceptionally tax-effcient vehicle but with a limited allowance. We might question whether it makes sense to deplete the client's ISA pot with fees where other options exist. However, sometimes facilitation can offer an advantage over direct payment and this may often be the case with registered pension schemes.

Why facilitate pension-related advice fees direct from the pension scheme?

As ever, there will always be exceptions, but as a general proposition taking advisers fees direct from the pension is likely to convey advantage to the client. Firstly, taking fees from the pension scheme is normally more efficient since tax relief on contributions effectively reduces the net cost of fees. Secondly, in the post-crystallisation/retirement phase, fee payments from the pension are normally more tax efficient than paying the fee from income taken. However, strict rules apply and it is critical to remain within them or serious consequences will unfold for the client.

Background legislation – scheme administration member payments

The underlying tenet of pension legislation is to restrict the types and amounts of payments that can be made by the scheme from the member's pension fund. The legislation prescribes a definitive list of permitted or 'authorised payments' and provides that any other payment is ipso facto an 'unauthorised payment'. In addition to the things you would expect to see as authorised, such as a tax-free cash lump sum and a pension, the list of authorised payments includes what are termed 'scheme administration member payments'. In essence, these are payments by the pension scheme, in respect of the member, made for the purposes of administration or management of the pension scheme. This includes paying fees to professional advisers but the amount must be reasonable and paid at a rate commensurate with an 'arm's length' rate. Any excess amount paid over this rate is an 'unauthorised member payment'.

Adviser charging – a permitted scheme administration member payment

Payment by a registered pension scheme to a financial adviser to meet pension advice costs is an authorised member payment provided the payment is made as a result of:

- a genuine commercial remuneration agreement between member and adviser; and
- is made for the pension advice given by the adviser in relation to that pension scheme; and
- the amount of the fee is appropriate to the service provided in respect of the advice given

If the fee costs are not genuinely commercial this will create an unauthorised member payment.

The amount of the unauthorised member payment would be the excess amount over the genuinely commercial cost for the pension advice concerned. If the fees do not relate to pensions advice on that pension scheme, then the whole payment will be an unauthorised member payment.

What does the term 'pension advice' mean?

Pension advice means advice concerning or connected with the particular pension involved and that advice can be in relation to:

- asset allocation and fund choice
- pension provider
- pension taxation
- checking against the various statutory limits

It can also cover advice on:

- income optimisation from that pension fund at/in retirement
- investment return optimisation on that pension fund
- more general advice on the payment outcomes/risks of choosing the type of pension to be taken (e.g. scheme pension, lifetime annuity or drawdown pension)

Advice costs also include any associated costs for implementation and administration covered within and arising from the advice given. For example, as part of giving pension advice, an adviser recommends a client to switch from one fund to another within a pension scheme. The adviser then implements the recommendation on behalf of the member by arranging for the funds to be switched and the adviser charges the client for undertaking that implementation work.

What does not constitute 'allowable' pension advice?

The advice must relate to pension advice on that particular registered pension scheme and unrelated advice is not allowable. Firstly, it is not allowable to charge fees to one pension scheme where the fee relates to advice given on another pension scheme. The payment must relate to costs for advice related to the pension scheme in question. Secondly, the fee cannot cover amounts related to wider matters not associated with the pension, albeit they may be relevant in the overall context of planning for retirement or planning at retirement. For example, costs for advice in relation to ISAs or other investments are not allowed. The amount of any unauthorised payment would be the amount of the costs that did not relate to pensions advice connected with the registered pension scheme in point.

What happens if adviser fees exceed what is allowable?

It will constitute an unauthorised member payment by the scheme and will be liable to an income tax charge known as the 'unauthorised payments charge'. The person liable to the charge is the individual scheme member for whom the payment was made and the tax charge is at a rate of 40% on the amount of the unauthorised payment. A person is liable to the unauthorised payments charge even if they are not resident or domiciled in the United Kingdom and it is a free-standing tax charge, which means, for example, any losses a taxpayer may have cannot be set against the tax charge.

The individual liable to the tax charge has the obligation to report and declare the unauthorised payment on their Self-Assessment return. Where someone does not receive a Self-Assessment return they must report their chargeability to tax in respect of the unauthorised payment to HMRC.

In certain circumstances, albeit perhaps unlikely in the context of fees, the individual may become liable to an additional 'unauthorised payments surcharge' of 15%. The rules are complex but in brief this is triggered where total unauthorised payments to a member in a given 12-month reference period exceed 25% of the fund values.

In addition to the individual tax charge, the pension scheme will generally be liable to an additional 'scheme sanction charge'. This is set at a rate of 40% of the unauthorised payment, although it will reduce to 15% provided the individual member has fully paid the tax due.

It is critical to understand that fee payments from a pension scheme must not exceed the permitted authorised amounts. Considerable tax penalties can apply and such unauthorised payments will likely contravene the scheme rules. Most schemes rules provide for the administrator to demand repayment of unauthorised payments previously believed to have been authorised, and for any unauthorised payment tax charges to be paid from the member's fund.

Specific items

Within the general treatment there are particular circumstances worthy of closer examination, as follows.

Adviser fees and purchasing a pension lifetime annuity

An adviser charge for pension advice can be a scheme administration member payment where the member is purchasing a lifetime annuity (either open market option or in-house option). This applies whether the charge is deducted from the member's funds before they are passed from the pension scheme to the chosen annuity provider or is deducted by the annuity provider after the member's funds have been passed from the pension scheme.

Provided the fee is for advice relating solely to the annuity purchase, it will be an authorised payment and will not have any bearing on the maximum amount of Pension Commencement Lump Sum (PCLS) (a.k.a. 'tax-free cash'). Broadly, the maximum PCLS is one-third of the amount applied to purchase the annuity, and fees for the annuity advice are considered to be part of the overall funds applied in connection with the annuity purchase. This would cover payment of fees in relation to any of the following:

- advice in relation to exercising the in-house lifetime annuity option/open market option
- advice about the type of lifetime annuity
- advice concerning from whom the lifetime annuity should be bought
- advice on how to maximise income from the pension fund at retirement
- advice on choosing the type of pension taken

For the purposes of establishing the amount that is being used or applied in connection with the annuity purchase, fees for wider pension advice cannot be included simply because that happens to be given at the same time as the advice leading to the annuity purchase. For example, advice about the investment of other pension funds that are being left in force and not being considered as part of the member's pensions options. The annuity-related advice must relate directly to the pensions options of the member and the member's retirement fund being used to purchase the annuity. It follows from this that an annuity provider will probably only facilitate a fee that relates solely to annuity advice, so as to ensure it is an authorised payment.

That is not to say a fee cannot be facilitated regarding the wider advice on other funds that are being left in force, but that fee relates to those funds and not the annuity purchase pot. For example, assume £100,000 of a total pot of £200,000 is being used to purchase an annuity. A total fee of £2,000 is raised to cover work of £1,000 on the pension options and the annuity purchase and £1,000 for investment advice on the uncrystallised funds being left in force. Both aspects taken separately may well be authorised payments but only £1,000 relates to annuity purchase. If the total amount being charged of £2,000 is deducted from the member's funds before being passed from the scheme to the annuity provider, the amount being applied in connection with annuity purchase is £99,000 not £100,000 and the PCLS is based on this amount.

Adviser fees deducted when designating funds for a drawdown pension

As with the purchase of a lifetime annuity, an adviser charge for pension advice when a member designates funds available for a drawdown pension can be considered as a scheme administration member payment.

However, how and when the adviser charge is deducted at the time of designating funds for a drawdown pension can have a bearing on the maximum PCLS. The amount of tax-free lump sum is based on the amount of the designated funds. Broadly, the maximum sum is one-third of the funds designated. Provided the fees are deducted after the member has designated funds for the drawdown pension, there should be no bearing on the maximum PCLS. If the charge is taken before designation it follows that the PCLS will be lower as the amount being designated is lower. Similarly, the maximum 'GAD' income withdrawal under a capped arrangement will be slightly lower too. When fees are taken shortly after a basis amount has been established at a review point, the amount deducted can nevertheless be included as part of the member's drawdown pension funds at the review point. Put another way, a fee taken shortly before a review date will reduce the maximum income available, whereas one taken shortly after will not.

Adviser fees deducted when taking a trivial commutation lump sum

When a trivial commutation lump sum is paid in respect of uncrystallised rights, 75% of the lump sum is treated as taxable pension income and the remaining 25% is tax-free. When an adviser charge for pension advice is deducted from the member's funds at the time of the trivial commutation, the 75% taxable and 25% tax-free elements are based on the amount actually paid to the member after deduction of the adviser charges.

When it might not make sense to facilitate fees directly from the pension

There will always be individual circumstances where it may not be advantageous or may be less advantageous to facilitate fees from the pension scheme. In particular, this will need to be considered where the client is effectively unable to replenish the tax-efficient pension pot. Examples include:

- where a client has enhanced or fixed protection
- where the client is aged over 75
- in certain circumstances, where the client wishes to maximise use of their annual allowances and ensure the maximum amount remains invested in the pension

In summary

It is often likely to be beneficial to your client to have an adviser fee facilitated direct from their personal pension scheme but it is vital to stay within the prescribed limits and guidance. The adviser will know the type of advice being provided, the fees being charged and the interaction with the client's pensions.

The golden rules are:

- keep pension fee facilitation within the prescribed limits
- do not facilitate fees for non-pension advice from pensions
- facilitate fees for advice on a particular pension scheme from that pension and do not facilitate fees for advice given on one pension scheme from another pension scheme
- take care where fees may influence entitlement to tax-free cash or other limits.

This is a brief summary document only based on published guidance from HMRC as at June 2014 and is not intended to act as a guide upon which advisers should base any decision to arrange fee facilitation or base tax treatment of their fees. Relevant primary materials, including but not limited to, underlying primary and secondary legislation and HMRC guidance and practice must always be consulted at all times for all purposes. Appropriate advice should always be sought from a relevant professional adviser. No party should act or refrain from acting on anything contained in this material. No statements or representations made in this document or any otherwise made in association with this document are legally binding on Fidelity or the recipient and no liability is accepted in connection with this material. FundsNetwork cannot give advice regarding tax. This paper contains Public Sector information licensed under the Open Government Licence v1.0.

7. Pension scheme exit charges and the 1% cap

Since 31 March 2017, product exit charges for existing members of personal and stakeholder pension schemes have been capped at 1% by the Financial Conduct Authority (FCA). This was introduced so individuals were not penalised if they wanted to move their assets, for example to access the flexibility introduced by the pension freedoms that aren't available with their current provider.

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The change in rules explained

- The charge is capped at 1% of the value of the member's benefits being taken, converted or transferred from a scheme
- It cannot be increased by schemes that had exit penalties of less than 1%
- Applies after normal pension age (i.e. 55) but before expected retirement date
- Only applicable to contract-based personal pensions (including workplace personal pensions) and stakeholder schemes. The Department for Work and Pensions (DWP) extended the regime to occupational pension schemes from 1 October 2017.
- Other charges, for example with profit Market Value Adjustments (MVAs) and dilution adjustments, are excluded from the definition of early exit charges
- Fees for entering into decumulation, i.e. drawdown, are not considered early exit charges

The opportunities for you and your clients

Pension schemes or individual pension products that do not have the flexibility built in to take advantage of the pension freedoms are normally old legacy pension products or employer based occupational schemes, which may have other disadvantages such as:

- Limited investment options (both funds and assets such as Exchange Traded Investments)
- Model portfolios unavailable
- Higher charging structures
- Cannot facilitate adviser fees
- Limited online access
- Paperwork still needs to be completed

Since the early exit fees cap was introduced a number of providers have either revised their charges or scrapped them altogether, which can allow clients to move their assets to a solution which may better fit with their requirements for retirement planning.

Why not take a look at the FundsNetwork Pension, which is a modern, flexible and cost-effective solution and has become increasingly popular for pension transfers since its launch. We are members of Origo, which may assist in moving clients' assets in a more efficient way. The value of investments and the income from them can go down as well as up and clients may get back less than they invest. Tax treatment depends on individual circumstances and all tax rules may change in the future.

For more information visit fundsnetwork.co.uk/pension.

To read the FCA's full policy statement (PS16/24) visit fca.org.uk

8. The pension lifetime allowance

The pension lifetime allowance (LTA) was introduced as part of 'pension simplification' back on A-Day in April 2006. However, LTA planning can be far from straightforward given the constant changes made to the allowance over the years. In this guide, we examine some of the aspects of the lifetime allowance and how it can affect retirement planning.

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Introduction to the lifetime allowance

The allowance is set at £1,030,000 in the 2018/19 tax year, although it has altered numerous times since it was initially introduced at £1.5 million in 2006. As the table shows, the LTA reached a peak of £1.8 million in 2011 and steadily reduced up until 2016/17. This downward trend has now reversed and the LTA now increases each year in line with inflation (CPI).

The LTA applies to both defined contribution (DC) and defined benefit (DB) pension schemes, with the benefits broadly valued in the following way (more information on valuations can be found in section 4):

- **Defined contribution schemes** – the value of the individual's pension savings (whether used to take an income or withdrawn as lump sums)
- **Defined benefits schemes** – usually 20 times the pension the individual receives in the first year plus any lump sum taken. So, for example, a final salary pension of £20,000 per annum will be valued at £400,000 (20 x £20,000) for the purposes of the LTA calculation.

Any entitlement to the UK State Pension has no impact on the LTA.

The standard lifetime allowance over the years	
2006/07	£1.5 million
2007/08	£1.6 million
2008/09	£1.65 million
2009/10	£1.75 million
2010/11	£1.8 million
2011/12	£1.8 million
2012/13	£1.5 million
2013/14	£1.5 million
2014/15	£1.25 million
2015/16	£1.25 million
2016/17	£1 million
2017/18	£1 million
2018/19	£1.03 million
2019/20	£1.055 million

Transitional protection

With the introduction of the LTA in 2006, and at each time the allowance has been reduced, the government introduced protection measures to safeguard those people affected by the reduction. There are a number of regimes in place, which in essence gives the person applying for the protection their own personal LTA.

Lifetime allowance protections

Effective from	Protection type	Protection level	Continuing contributions?
April 2006	Primary	£1.8 million + enhancement factor (LAEF)	Yes
April 2006	Enhanced	Unlimited	Please see the section below on enhanced protection
April 2012	Fixed 2012	£1.8 million	No
April 2014	Fixed 2014	£1.5 million	No
April 2014	Individual 2014	£1.25 – £1.25 million	Yes
April 2016	Fixed 2016*	£1.25 million	No
April 2016	Individual 2016*	£1 – £1.25 million	Yes

* Still available if qualification criteria met

Primary protection (PP)

Primary protection was introduced to protect people with pension savings of £1.5 million or more on 5 April 2006. It was also possible to include tax free cash entitlements within primary protection. It allows individuals to continue to make pension contributions after they have been granted protection. A person with this type of protection has a personal LTA (calculated when they take pension benefits), which is arrived at using a lifetime allowance enhancement factor (please see the box below).

Applications for primary protection were allowed until 5 April 2009. Once relied upon, it cannot be revoked and can only be lost in the event of a pension debit as a result of a pension sharing order following divorce.

Primary protection – calculating a personal LTA

A personal LTA is calculated using a lifetime allowance enhancement factor (LAEF), which is **added** to the standard LTA. This factor is calculated as follows:

(Value of the individual's pension rights as at 5 April 2006 – £1.5 million) / £1.5 million

So, if someone had protected pension benefits of £3 million, their enhancement factor would be:

(£3m – £1.5m) / £1.5m = 1

The protection amount increased in line with changes to the standard lifetime allowance. When the LTA decreased to £1.5 million on 6 April 2012, individuals with primary protection retained a protected amount based on an underpinned LTA of £1.8 million. So, in the instance given above, the additional factor is 1 x £1.8 million, making a personal LTA of £3.6 million (£1.8m + £1.8m).

Enhanced protection (EP)

Anyone with certain pension rights as at 5 April 2006 could apply for enhanced protection, regardless of the value of their funds at that time (although any rights deemed excessive under occupational pension rules had to be surrendered). It was also possible to include tax free cash entitlements within enhanced protection. Any growth in the pension fund is also covered by the protection.

The attraction of this type of protection is that the individual is not tested against the lifetime allowance when they take benefits and so there will never be an LTA excess charge. However, enhanced protection will be lost in the following circumstances:

- Where 'relevant benefit accrual' occurs under any arrangement in a registered pension scheme
- Where a transfer is made from any arrangement holding rights for the individual and that transfer is not a 'permitted transfer'
- Where a new arrangement is made for the individual other than to receive a permitted transfer, as part of a retirement-benefits activities compliance exercise, or as part of an age-equality compliance exercise
- Where an arrangement receives an impermissible transfer
- Where the member notifies HMRC that they no longer wish to be covered by enhanced protection.

It should be noted that auto-enrolment can cause the loss of enhanced protection (unless an employee opts out within one month or the employer chooses not to enrol such an employee in a scheme as they are not required to do so). Receiving a pension credit can also affect whether this type of protection is lost. Whether an individual can rebuild pension rights, which have been reduced following a pension debit, depends on the type of arrangement.

Applications for this type of protection were allowed until 5 April 2009.

Fixed protection (FP)

This new form of protection was introduced on 6 April 2012, following the reduction of the LTA to £1.5 million from £1.8 million. It provides a fixed level of allowance based on the LTA available prior to the reduction. As the LTA has been reduced on three occasions, three types of fixed protection have been made available:

- **Fixed protection 2012 (FP 2012)** – providing a LTA of £1.8 million (individuals wishing to rely on FP 2012 had to notify HMRC by 5 April 2012)
- **Fixed protection 2014 (FP 2014)** – providing a LTA of £1.5 million (individuals wishing to rely on FP 2014 had to notify HMRC by 5 April 2014)
- **Fixed protection 2016 (FP 2016)** – providing a LTA of £1.25 million (FP 2016 is still available – applying for this type of protection is covered in the box on the next page).

This type of protection will be lost if the following conditions are not met:

- The individual cannot start a new arrangement other than to accept a transfer of existing pension rights
- The individual cannot have benefit accrual
- The individual is subject to restrictions on where and how they transfer benefits.

Auto-enrolment can also cause the loss of fixed protection (unless an employee opts out within one month or the employer chooses not to enrol such an employee in a scheme as they are not required to do so). Receiving a pension credit can also affect whether this type of protection is lost. Whether an individual can rebuild pension rights, which have been reduced following a pension debit, depends on the type of arrangement. If a person breaches any of the conditions for retaining fixed protection, such as starting a new pension arrangement, they must inform HMRC.

If, in future, the standard LTA rises above the level of protection offered by FP 2012, FP 2014 or FP 2016, the standard LTA will then apply.

Individual protection (IP)

This type of protection (IP 2014) was introduced on 6 April 2014, following the reduction of the LTA to £1.25 million from £1.5 million. IP 2016 was made available from 6 April 2016, following the reduction of the standard LTA to £1 million.

Individual protection results in a personal LTA:

- **Individual protection 2014 (IP 2014)** – providing protection equal to the value of the person's pension rights on 5 April 2014 subject to a minimum of £1.25 million and capped at £1.5 million. Individuals wishing to rely on IP 2014 had to notify HMRC by 5 April 2017
- **Individual protection 2016 (IP 2016)** – providing protection equal to the value of the person's pension rights on 5 April 2016 (providing these were more than £1.0 million) and capped at £1.25 million. IP 2016 is still available – applying for this type of protection is covered in the box below.

To apply for this type of protection, an individual must calculate the value of their pension savings as they stood on 5 April 2014 (for IP 2014) or 5 April 2016 (for IP 2016). This valuation is the total of four amounts:

- **Amount A** – any pension that the member started to receive before 6 April 2006
- **Amount B** – any pension that came into payment after 5 April 2006 but before 6 April 2014 (for IP 2014) or 6 April 2016 (for IP 2016)
- **Amount C** – pension savings that the member has not yet taken from their registered pension scheme
- **Amount D** – pension savings that the member has not yet taken from certain overseas pension schemes.

Unlike enhanced and fixed protection, it is possible to maintain contributions and accruals in pension schemes without losing IP 2014 or IP 2016. There is only one scenario where IP 2014 or IP 2016 may be reduced or lost. This is if the person becomes subject to a pension debit as a result of a pension sharing order following divorce (they must inform HMRC if this is the case).

If, in future, the standard LTA rises above an individual's personal LTA, the standard LTA will then apply.

Applying for FP 2016 or IP 2016

Clients can apply for protection online at the following address (they will need a Government Gateway user ID and password to use this service).

www.gov.uk/guidance/pension-schemes-protect-your-lifetime-allowance

There is no application deadline for these protections. However, to rely on the relevant protection, the client must have applied for and received a reference number from HMRC before their pension is tested against the LTA and they must have adhered to the relevant conditions. This applies even when the benefits being taken are worth less than the standard LTA.

Having more than one type of protection

It is possible for a client to have more than one type of protection, as indicated by the table below.

	PP	EP	FP 2012	FP 2014	FP 2016	IP 2014	IP 2016
PP	–	Yes	No	No	No	No	No
EP	Yes	–	No	No	No	Yes	Yes
FP 2012	No	No	–	No	No	Yes	Yes
FP 2014	No	No	No	–	No	Yes	Yes
FP 2016	No	No	No	No	–	Yes	Yes
IP 2014	No	Yes	Yes	Yes	Yes	–	No
IP 2016	No	Yes	Yes	Yes	Yes	No	–

Notes:

1. Enhanced protection takes precedence over primary and individual protections (i.e. the latter types are dormant)
2. Fixed protections take precedence over individual protections (i.e. the latter is dormant).

LTA enhancements/reductions

In addition to the transitional protections covered above, there are other situations where someone's LTA can be adjusted (subject to certain conditions). These are as follows:

Possible enhancements

1. Where a client transfers a recognised overseas pension to the UK which hasn't benefited from UK tax relief.
2. If a "disqualifying" pension credit is received following divorce, for benefits where payment started after A-Day, then an enhancement may be made, as the benefits have already been tested against the LTA.
3. In limited circumstances and subject to certain conditions, a client with a UK-registered pension scheme may be able to apply for an enhancement where all or some of their benefits have accrued while they were a non-UK resident.

Possible reductions

1. While any pension in payment prior to A-Day will never trigger a LTA tax charge in itself, the value of any pensions in payment are tested at the first benefit crystallisation event (these are listed in section 4) post A-Day, effectively reducing the available LTA. This reduction is covered in section 4 under 'Further notes related to BCEs'.
2. Any member with a protected retirement age of under 50 will have a reduced LTA if they take benefits before age 50 (it is reduced by 2.5% for each complete year between the date on which the benefit crystallisation event occurs and the date on which the individual will reach age 55).

Benefit crystallisation events (LTA test trigger events)

The legislation specifies the occasions when pension benefits must be tested against the lifetime allowance. If the member does not have sufficient LTA available, then a tax charge is likely to apply.

There are a number of scenarios which trigger a test and these are known as benefit crystallisation events (BCEs). There are 13 BCEs as shown in the table below. These generally only happen before or at age 75 (the exception is BCE 3 which can occur at any age).

LTA test trigger events	Valuation for BCE purposes	Tax charge (if LTA is exceeded)	Notes
BCE 1 Designating funds to drawdown during the member's lifetime (DC arrangements)	The value of funds (market value) placed into drawdown	25%	If the funds are subsequently used to purchase an annuity or to provide a scheme pension, an allowance is made for this as the funds have already been tested against the LTA (this is known as prevention of overlap).
BCE 2 When the person becomes entitled to a scheme pension before the age of 75 (whether a DB or DC arrangement)	Starting pension (the amount paid in the first 12 months) x 20 (the relevant valuation factor)	25%	If entitlement to a scheme pension or lifetime annuity payments arises before normal minimum pension age, and the member does not satisfy the ill-health provision and does not have a protected pension age, a test will only be triggered under BCE 2 when the member reaches normal minimum pension age. If the scheme rules allow for a pension to increase by more than the permitted amount in a year (usually the greatest of 5%, RPI or £250), the member is likely to fall within the scope of BCE 3. To avoid this, a scheme administrator may approach HMRC to negotiate a relevant valuation factor (RVF) of more than 20. Where entitlement to a scheme pension arises from assets taken from a drawdown fund, an allowance is made for this as the funds have already been tested against the LTA (prevention of overlap).
BCE 3 Where a scheme pension already in payment increases beyond a permitted margin	Value of increase above permitted maximum x 20 (RVF)	25%	A test is generally triggered when the annual increase is more than the greatest of RPI, 5% or £250. An increase can be greater than 5% if the scheme administrator has agreed with HMRC a relevant valuation factor (RVF) of more than 20. Where a test has already been triggered through BCE 3, an allowance is made for this if the pension is increased again beyond the permitted margin (prevention of overlap).

Benefit crystallisation events (LTA test trigger events) continued

LTA test trigger events	Valuation for BCE purposes	Tax charge (if LTA is exceeded)	Notes
BCE 4 Purchase of a lifetime annuity from a DC arrangement before age 75	Value of the purchase (market value of funds), less the value of any amounts previously crystallised under BCE 1 if funds come from drawdown	25%	If a lifetime annuity is purchased before normal minimum pension age, and the member does not satisfy the ill-health provision and does not have a protected pension age, a test will only be triggered when the member reaches normal minimum pension age (the amount crystallises through BCE 2).
BCE 5 Uncrystallised defined benefits at age 75	Value of deferred scheme pension at 75th birthday x 20 (RVF) plus any lump sum not provided by commutation of pension	25%	If the scheme rules allow for a pension to increase by more than the permitted amount in a year (usually the greatest of 5%, RPI or £250), the member is likely to fall within the scope of BCE 3. To avoid this, a scheme administrator may approach HMRC to negotiate a relevant valuation factor (RVF) of more than 20.
BCE 5a Reaching age 75 while still in drawdown	Value of drawdown fund (market value) less the amounts previously crystallised under BCE 1	25%	A BCE 5a at age 75 is **not** triggered where the individual already had a drawdown fund in payment at A-Day (unlike drawdown that starts on or after A-Day which triggers a BCE 1 immediately and then a further BCE 5a at age 75 if there is any residual drawdown fund).
BCE 5b Reaching age 75 with uncrystallised money purchase funds	Value of the uncrystallised funds	25%	
BCE 5c A member dies before age 75 and uncrystallised funds are designated to beneficiary flexi-access drawdown (after 5 April 2015) within the relevant two-year period	Value of funds (market value) designated as available for drawdown	25%	The relevant two-year period starts on the date on which the scheme administrator first knew of the death or, if earlier, the day when they could first reasonably have been expected to know of it.
BCE 5d A member dies on or after 3 December 2014 and before age 75, and uncrystallised funds are used to purchase a beneficiary annuity (after 5 April 2015) within the relevant two-year period	Value of funds used to purchase annuity	25%	The relevant two-year period starts on the date on which the scheme administrator first knew of the death or, if earlier, the day when they could first reasonably have been expected to know of it.

Benefit crystallisation events (LTA test trigger events) continued

LTA test trigger events	Valuation for BCE purposes	Tax charge (if LTA is exceeded)	Notes
BCE 6 Payment of a relevant lump sum before age 75 (other than on death): – Pension commencement lump sum (PCLS) – Serious ill health lump sum – Uncrystallised funds pension lump sum (UFPLS) – Lifetime allowance excess lump sum	Value of the relevant lump sum paid to the individual	55%	The payment of an UFPLS is restricted to the amount of remaining LTA. If a larger lump sum is paid, the excess is treated as a lifetime allowance excess lump sum.
BCE 7 Payment of a lump sum death benefit, before age 75, from uncrystallised funds if paid within two years*	The value of the lump sum benefit	55%	* The two-year condition only applies to uncrystallised funds lump sum death benefits paid after 5 April 2016.
BCE 8 Transfer to a qualifying recognised overseas pension scheme (QROPS) before age 75	Value of the transfer (market value), less any reduction for overlap	25%	Where a BCE 1 or a BCE 2 test has been previously applied, overlap provisions apply. Where an overseas transfer charge applies in respect of the transfer, the amount that is deemed to crystallise as a BCE 8 is the gross amount being transferred before the deduction of the overseas transfer charge.
BCE 9 Certain payments that constitute a prescribed event: – Payments of arrears of pension after death – Lump sums basedon pension errors – PCLS-type lump sums paid after death	Regulations will value and prescribe	55%	

Further notes relating to BCEs

a) Pensions in payment on 5 April 2006

A pension in payment on 5 April 2006 (known as a pre-commencement pension) is only taken into account for LTA purposes when a BCE first occurs for a client (if no BCE ever occurs, then the pre-commencement pension will never be considered for LTA purposes).

When the first BCE occurs, the LTA available at that BCE will be reduced by the crystallised value of any pre-commencement pension in payment at that time, as valued immediately before that BCE. This is calculated by multiplying the annual rate of the pension in payment at the point of calculation, by a conversion factor of 25:1. No actual BCE occurs in respect of the pre-commencement pension and so no chargeable amount will ever be generated by it.

b) Where BCEs occur simultaneously

Normally BCEs use up a member's LTA in the chronological order in which they occur. The exception is where a pension commencement lump sum (PCLS) is paid and the BCE 6 test is conducted before the crystallisation of the associated BCE1, BCE 2 or BCE 4. Subject to this, the member must decide the order of the BCEs for the purpose of the LTA test. This is an important consideration if the client's LTA allowance is breached at this point, as the order determines which event creates the excess and is subject to the tax charge.

c) Phased retirement

Where a client draws an entitlement in stages, whether through fund designation in a DC scheme or through staggering a scheme pension or other benefit entitlement, each fresh entitlement is a separate BCE. So, if a client has a DC fund valued at £400,000 and they draw half of the fund at age 58 (e.g. £50,000 as a PCLS and £150,000 designated to drawdown), BCE 6 and BCE 1 occur at this time. If they draw the remaining fund in five years time, further BCEs will occur and a second LTA test will take place at that time.

d) Payment of a lifetime allowance excess lump sum

Where a client's LTA has been fully used up, any further benefit entitlement may, if the scheme permits (and the client is under age 75,) be commuted and paid entirely as a lump sum payment. The sum paid will then crystallise through BCE 6, giving rise to a chargeable amount.

e) BCEs and repayment of the overseas transfer charge

If a client makes a QROPS transfer that is subject to the overseas transfer charge, there are instances where this tax charge is repaid (broadly when it is paid in error or due to a change in circumstances). This repayment, which is made to the scheme administrator, must be used to provide benefits, or a transfer, in accordance with the scheme rules. If a BCE occurs in respect of these funds, an adjustment can be made to account for the fact that they have already been tested as a BCE 8.

Example of lifetime allowance and BCE calculation

December 2010	May 2015	May 2016	June 2018
Takes Pension Commencement Lump Sum of £200,000 and designates £600,000 to capped drawdown	**Puts a defined benefit scheme into payment with an initial yearly income of £10,000 per annum**	**Applies for Fixed Protection 2016**	**Decides to purchase an annuity with her capped drawdown fund valued at £800,000**
How much of the lifetime allowance has been used and therefore how much is remaining?			
PCLS triggers BCE 6 £200,000 of £1.8 million LTA = **11.11%** used and **88.89%** remaining Drawdown designation triggers BCE 1 £600,000 of £1.8 million LTA = **33.33%** used and **55.56%** remaining	Scheme pension triggers BCE 2 (10,000 x 20) £200,000 of £1.25 million LTA = **16%** used and **39.56%** remaining		Annuity purchase triggers BCE 4 £800,000 – £600,000 (allowing for overlap) = £200,000 of £1.25 million LTA = **16%** used and **23.56%** remaining

The lifetime allowance charge

If a client exceeds their lifetime allowance a tax charge will be payable on the amount beyond the available LTA. The principle behind this charge is to broadly recover the tax reliefs given over time – both on the initial payments and on the build-up of those funds over the years.

The exact charge will depend on how the excess pension funds are taken and is based on the gross value of the benefits exceeding the available LTA. Broadly:

- If the excess is paid out as a lump sum it is subject to a 55% tax charge
- If it is left as pension benefits, the excess is subject to a 25% tax charge. The client remains liable for income tax on any income received after the 25% charge is paid.

The rate of tax applied to each BCE can be found in section 4. Liability for the charge depends on whether the charge arises during the member's lifetime or following their death:

- **During the member's lifetime** – the scheme administrator and member are jointly and severally liable (although in practice the scheme administrator is obliged to account to HMRC for the charge after the BCE)
- **Following the member's death** – personal representatives are required to notify HMRC and liability rests on the recipient of the payment for BCE 7 and on the relevant nominee/dependant for BCE 5c or BCE 5d.

The tax is deducted in different ways depending on the type of arrangement – from the capital for a defined contribution scheme and through a reduction in benefits from a defined benefit scheme.

Excess charge example

Client with £500,000 of defined contribution funds in excess of the lifetime allowance (no protection is in place):

If taken as a lump sum (55% tax charge):

- Excess pension fund = £500,000
- Tax deducted = £275,000
- Net proceeds = £225,000 (outside pension for IHT and tax but no further LTA charges will potentially be applicable on these funds)

If left as pension benefits (25% tax charge):

- Excess pension fund = £500,000
- Tax deducted = £125,000
- Net proceeds = £375,000 (inside pension regime for tax on growth and IHT but could suffer charge on subsequent growth)

Information requirements

The LTA system is supported by an information exchange and reporting regime. There are different systems for reporting and paying the lifetime allowance charge depending on whether the BCE occurred during the member's lifetime or as a result of a BCE after the death of the member.

Before the BCE

If a member wants to rely on a form of LTA protection, they must give the scheme administrator the reference number issued by HMRC in connection with the relevant form of protection. If a member wants to rely on individual protection (IP 2014 or IP 2016), they must also give the scheme administrator details of the relevant protected amount.

After the BCE

Whenever a BCE occurs, the member must be given a statement telling them how much LTA has been used up by the event. This information will enable the member to work out if they have any LTA available at subsequent BCEs, and correctly complete any tax return. This requirement will fall either on the scheme administrator or an insurance company.

Where liability to the lifetime allowance charge arises, the scheme administrator must also give the member the following information:

- The chargeable amount that has arisen as a result of the BCE
- Details of how the chargeable amount has been calculated
- The amount of tax due
- Whether they have accounted for the tax, or intend to do so at a later date.

The scheme administrator must give the member a BCE statement:

- At least once every tax year if the member is receiving a pension from the scheme (this includes the member having designated funds to provide a drawdown pension), ending in the tax year in which the member reaches age 75
- Where they are not required to provide an annual BCE statement within three months of the BCE occurring (the exception is where they have to notify a deceased member's personal representatives).

Important information

This document provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations. The value of benefits depends on individual circumstances. Withdrawals from a pension will not normally be possible until age 55. Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning.

9. The annual allowance charge Scheme Pays

The annual allowance was introduced with A day in the 2006/07 tax year. The essential principle of the allowance is to limit the amount of 'Tax privileged' pension savings an individual can accrue each tax year. The limit applies to all pension savings, including those made by the individual themselves or by their employer or any other third party. However, the annual allowance is not a restriction on the amount of tax relief given when the savings are made, but works by applying a tax charge when the allowance is exceeded.

The client will always be personally liable for this tax, regardless of whether the contribution was made by them, their employer or someone else. They may have to pay this directly to HMRC or, in some cases, it may be possible to pay it from their pension account – this is known as 'Scheme Pays'. All pension schemes must facilitate payment of the tax charge when requested to if certain conditions are met – this is known as 'Mandatory Scheme Pays'.* Some providers, including FundsNetwork, are more flexible and can facilitate payment of the charge when the mandatory conditions are not met. This is known as 'Voluntary Scheme Pays'.

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The annual allowance charge – the basics

The annual allowance applies to savings in occupational and personal pension schemes made by an individual, their employer and on their behalf by someone else. If the person goes over an annual allowance once all their pension savings have been added together, they may have to pay an annual allowance tax charge. The amount of the charge will depend on the excess amount, how much the person has earned in the tax year and whether they have any unused annual allowance they can carry forward to reduce or potentially eliminate the charge.

A client's annual allowance will depend on certain factors. It is likely to be a very personal figure for the client, as it will be based on the current tax year's annual allowance, plus the value of any unused allowances carried forward from the previous three tax years. The standard annual allowance for the 2019/20 tax year is £40,000 but this could be lower, as shown by the table opposite.

Type of annual allowance	Limit 2019/20 tax year
The standard annual allowance This applies to everyone who isn't affected by the tapered annual allowance.	**£40,000**
The tapered annual allowance For those affected by the tapered annual allowance their annual allowance will be reduced by £1 for every £2 of 'adjusted income' above £150,000. This is subject to a minimum of £10,000. Please see our factsheet on tapered annual allowance for further details of how tapering works.	**A sliding scale from £40,000 down to £10,000**

Money purchase annual allowance (MPAA)

Clients that have triggered the MPAA will have an 'inner' restriction on the amount of pension savings that can be made to money purchase arrangements. This will not reduce the client's overall annual allowance but will limit the amount of total pension savings to money purchase arrangements to £4,000 (for the 2019/20 tax year).

Please be aware that if a client triggers the MPAA during a tax year, they may need to measure their contributions against two or three annual allowances.

Calculating the charge

If, after following the process below, either the annual allowance or money purchase annual allowance have been exceeded, then a tax charge will be calculated on the excess amount for the tax year in question. Broadly speaking, the charge will be calculated by notionally adding the excess amount to the client's taxable income for the year and charged at the client's marginal rate (or rates if an income tax threshold is crossed). The annual allowance excess will not have any effect on reducing or removing the client's personal income tax allowance.

*It may not always be possible, in certain situations, when entering the scheme or if the scheme is under Pension Protection Fund assessment.

Case Study 1 – calculating the charge

Scenario 1: Total annual earnings of £70,000

Mike and his employer have contributed £60,000 to his occupational pension during the 2018/19 tax year. He has the standard annual allowance of £40,000 available and has no unused allowances to carry forward from previous years. His total taxable income for the year is £70,000.

Scenario 2: Total annual earnings of £140,000

Had Mike's taxable income before the charge been £140,000, half of the excess would be charged at the higher rate (40%) and half would be charged at the additional rate (45%). This is because the £20,000 excess contribution is notionally added to his total annual earnings of £140,000, taking him over the threshold for additional rate tax of £150,000.

The above examples are based on UK Income Tax rates. Rates for Scottish Residents differ.

Paying the charge

If a charge is due, then the next step is deciding how to pay it.

1. Direct payment to HMRC

In some circumstances, the client may have to pay the charge directly to HMRC themselves, typically through self-assessment.

2. Scheme Pays

It may be possible for the client to pay some or all of the charge from their pension account. This is often more palatable for the client and may also offer a pecuniary tax advantage. This is particularly relevant where the lifetime allowance is also a consideration. However, the other side to this equation is that pension benefits will be reduced. This may be simple to understand and calculate for a money purchase arrangement, but may be very complex and sometimes quite punitive for a defined benefit arrangement.

Scheme Pays

There are two types of Scheme Pays. Depending on the amount of the charge, how the charge arose and the client's circumstances, they may have access to one, both or neither of them.

Mandatory Scheme Pays

If certain conditions are met, the pension scheme must fulfil requests to pay the charge from the pension and it will become jointly and severally liable with the client for some or all of the tax charge. However, this option is available in a limited number of circumstances:

- When the charge is over £2,000* and
- The client has exceeded the standard annual allowance of £40,000 (for this purpose the tapered annual allowance and MPAA are ignored).

It does not apply when:

- The client has exceeded the tapered annual allowance and/or the MPAA, but has not exceeded the £40,000 standard annual allowance or;
- They have an overall charge of £2,000 or more but this is not based solely on the contributions to that scheme.

It partially applies when:

- The client has exceeded the tapered annual allowance or the MPAA and has exceeded the£40,000 standard annual allowance. In this situation, it will only cover any charge on the excess over £40,000.

*There is no minimum that the client can ask the scheme to pay but if this is less than £2,000 then they will need to confirm to the scheme that their total annual allowance tax charge liability is greater than £2,000.

Case Study 2 – Mandatory Scheme Pays

Sarita has put £60,000 into her pension and has a tapered annual allowance (TAA) of £15,000.

The above examples are based on UK Income Tax rates. Rates for Scottish Residents differ.

Voluntary Scheme Pays

Any pension scheme can offer Voluntary Scheme Payments but many do not. Where a scheme does offer this facility, there are no minimums and the scheme can pay any annual allowance tax charge even if the charge is not in relation to pension savings to that arrangement. In fact, it may even be possible to transfer benefits to an arrangement in order to facilitate this. However, where Voluntary Scheme Pays is offered, the scheme will never become jointly and severally liable for the charge and it remains the sole liability of the client. As such, the reporting and payment deadlines for Voluntary Payments are different to Mandatory Payments.

Voluntary Scheme Payments are available with the FundsNetwork Pension.

Deadlines for Scheme Pays requests

If a client wants to use the Scheme Pays facility, the deadlines for the request must be adhered to. If the deadline is missed, then the option may not be available. The deadlines for FundsNetwork Pension Scheme Pays requests are shown below.

For Voluntary Scheme Pays, the deadline ensures there is enough time for the tax charge to be received by HMRC, by the deadline for personal tax of 31 January following the end of the tax year. The client should wait to receive confirmation that the scheme is prepared to and has paid the tax charge before they submit their self-assessment form (this is not necessary for Mandatory Scheme Pays as, if the conditions are met, the scheme is obliged to pay the tax charge).

Where the client does not have all of the relevant information to calculate the charge, it is possible to pay an estimated tax charge. This would need to be corrected when the information is received.

FundsNetwork Scheme Pays deadlines
The following deadlines apply for Scheme Pays requests for our pension:

Scheme type	Tax year	Deadline
Mandatory Scheme Pays	2018/19	31 July 2020
Voluntary Scheme Pays	2019/20	31 August 2020

Next steps for FundsNetwork Scheme Pays requests

If a client has a FundsNetwork Pension from which they wish to pay an annual allowance tax charge – and are within our relevant deadline – you can request a Scheme Pays form on their behalf.

- Once you have completed and returned the Scheme Pays form on behalf of your client, we will arrange for the charge to be paid to HMRC within 45 days of the end of the reporting quarter.
- You or your client will need to complete the relevant sections of their self-assessment form or notify HMRC directly.

10. Pension transfer advice: contingent charging and other proposed changes

Summary of the FCA's Consultation Paper CP19/25

The pension freedoms introduced in 2015 have given consumers with defined contribution (DC) pensions more flexibility in how and when they can access their savings. As a result, a significant number of consumers with defined benefit (DB) pensions have transferred their savings to DC schemes, after taking mandatory advice.

The FCA believes that DB pensions offer extremely valuable benefits and that most customers would be best advised not to transfer. However, research has shown that 69% of consumers are advised to transfer. The regulator thinks this is too high and that many transfers have not been in the best interests of the consumer. Accordingly, the FCA considers that it needs to intervene to protect consumers and are consulting on a range of proposals relating to transfer advice. These are outlined in a Consultation Paper (CP19/25) and firms have until 30 October 2019 to pass on their comments to the regulator.

Here we briefly summarise the key points from the paper, although we recommend firms read the full text to see how they may be affected by the proposals.

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Ban on contingent charging

The FCA believes much of the poor advice on pension transfers is driven by conflicts of interest in the way advisers are remunerated. They are particularly concerned about the practice of contingent charging. In its purest form, this is where an adviser is only paid if a transfer or conversion takes place. The alternative to a contingent charging model is where the same amount is charged for advice, regardless of whether a transfer or conversion takes place or not. Many firms use hybrid contingent models that include some degree of contingent charging.

- The FCA thinks that the best way to reduce the scope for conflicts of interest and the potential harm caused by unsuitable advice is to ban contingent charging. This will require firms to charge the same amount for advice on pension transfers and conversions, irrespective of whether the advice results in a recommendation to transfer (or convert) or not.
- The requirement will incorporate all related and associated charges such as advice on where any transferred funds will be invested and implementation charges. To prevent gaming the ban, it will also apply across two-adviser models where one adviser advises on the transfer and another on where the fund might be transferred.
- This policy should discourage higher-risk firms from operating in this market. If firms believe they need to charge more for transfer advice, due to the risk of it being unsuitable, they should reconsider whether they are competent to provide suitable pension transfer advice at all.
- To mitigate the effect of the interventions on those who cannot afford advice, the regulator has identified groups of customers for whom a transfer or conversion is likely to be in their best interests, due to specific personal circumstances. These include those customers who have a specific illness or condition resulting in a materially shortened life expectancy and those facing serious financial hardship.
- The FCA proposes to exempt these 'carved out' customers from the ban on contingent charging, although they should not pay more for transfer advice than other consumers. Having identified a client who falls within one of the groups, if the adviser wishes to apply the carve-out, it should be made clear to the client before the advice process continues.
- The regulator has decided to rule out alternative measures, such as setting a monetary price cap on contingent charges, more prescriptive systems and controls for managing conflicts of interest and requiring separate firms to give the transfer advice and related investment advice.

Triage and abridged advice

Many advisers operate a triage service before they give DB transfer advice. This is where an initial conversation is held with the customer where factual information is given about the features of safeguarded and flexible benefits. The purpose is to enable customers to decide whether to take advice on the transfer or conversion of their pension benefits. However, during a previous review of firms' triage services, the FCA found that some forms of triage may be crossing the advice boundary.

- It remains the FCA's view that, as a non-advised service, triage should be an educational process that enables consumers to decide whether to proceed to regulated advice. If advisers give a professional opinion based on the client's circumstances that steers the client towards keeping or giving up their safeguarded pension benefits, they are likely to be crossing the advice boundary. The regulator is not able to change the advice boundary as it is set in legislation.
- Some firms have asked whether decision trees or traffic-light RAG-rated questionnaires can be used within a non-advised triage service. The way an adviser ranks the information gained through using these could suggest that the consumer takes one course of action over another (to transfer or convert, or not). For this reason, the FCA believes that decision trees and RAG-rated questionnaires are likely to lead to advice, so should not be used within a triage service.
- Given the limitations of triage, and the implications of the proposed ban on contingent charging, the FCA is proposing to introduce 'abridged advice'. This will act as a new mechanism to filter out those consumers for whom a pension transfer or conversion is unlikely to be suitable, before they pay for full advice. Firms will not be required to offer abridged advice but, if they do, it may only be offered for safeguarded benefits that require a Pension Transfer Specialist (abridged advice must be carried out or checked by a PTS).
- Abridged advice includes the initial stages of the usual advice process. The regulator would expect the adviser to conduct a full fact-find and risk assessment, including an assessment of the client's attitude to transfer risk in line with their guidance on assessing suitability. Based on this analysis, the adviser may provide the consumer with a personal recommendation not to transfer or convert their pension if they can demonstrate this is unlikely to be suitable.
- This recommendation can be made without an adviser having to collect detailed scheme data, undertaking an Appropriate Pension Transfer Analysis (APTA) or providing a Transfer Value Comparator (TVC). This should enable abridged advice to be provided cost-effectively.

- An adviser can only provide a personal recommendation not to transfer or convert their pension through abridged advice. This must be communicated to the client before the adviser initiates the process. The only other outcome is that abridged advice is insufficient to draw any conclusions on whether to make a personal recommendation to transfer (or convert) or not.
- The FCA has set out the information advisers may consider for the purposes of abridged advice. This is likely to include:
  – High-level health information to ascertain if the client has a materially reduced life expectancy.
  – The client's attitude to transfer risk including their capacity for loss.
  – The client's attitude to investment risk and their relevant knowledge and experience of investments.
  – A high-level understanding of the client's financial and family situation.
  – Other relevant information such as whether the client is relocating overseas.
- Based on the information collected through the abridged advice process, if it is unclear whether the client would benefit from a pension transfer or conversion, the adviser must check if the client wants to continue to full advice, and if they understand the associated costs.
- Advisers will need to prepare a suitability report, as they do for any other personal recommendation, and they will be liable for the advice provided.

Prioritising DC workplace pension schemes

- The FCA believes that there is a significant conflict arising where clients sign up for an ongoing advice proposition. This can result in charges being paid throughout a 20 to 30-year retirement period when a consumer transfers from a DB to a DC scheme. The regulator is therefore consulting on proposals to address the conflict of interest created by ongoing charges.
- The regulator has stated that if advisers recommend a default fund in a workplace pension scheme (WPS) as the receiving scheme, it's likely that a transferring member will not require advice again until decumulation. Product charges would also be capped at 0.75% each year. The result would be considerably lower charges than for other options.
- The FCA considers that if a transfer from safeguarded to flexible benefits is suitable, a default option within a WPS (if available) is more likely to be a suitable destination option for many consumers.
- If a WPS is not recommended, the regulator is proposing to require firms to demonstrate why the scheme they recommend is more suitable than a WPS. They have set out circumstances that they consider are valid reasons for not considering a WPS:
  – The client does not have access to a default fund with capped charges within a DC WPS either as an active or deferred member.
  – The scheme does not accept transfers in.
  – The advice sets out why and how the member will access the funds within 12 months of decumulating, and the WPS is incompatible with the way the pot will be accessed.
  – The member can demonstrate prior evidence of investment activity through an adviser or active investment choices as a self-investor (excluding investment in a mortgage endowment policy or a default fund of a WPS).
- The FCA has also set out guidance on circumstances that they consider are not valid reasons for considering a WPS in most cases:
  – The member is more than 12 months from starting to decumulate.
  – The member is within 12 months of being able to decumulate but it remains unclear if or how they will access a transferred pot at that time.
  – Insufficient fund choices.

Empowering consumers

The FCA are concerned that charges are unclear and consumers do not fully understand the implications of the advice they are given. A range of proposals have been made to help tackle these issues.

- Before firms provide regulated advice on a transfer or conversion requiring a PTS, the FCA is proposing that they must send a letter of engagement that sets out in monetary terms the amounts that would be paid under the various scenarios for both abridged and full advice.
- If an adviser operates the 'carve-out' and knows that a potential client would be eligible for non-contingent charging, the letter must explain:
  - The reasons for this.
  - That no charge would be payable in the event of a recommendation not to transfer or convert.
- If an adviser offers abridged advice, the letter must explain that a consumer will not be able to undertake a transfer if they have only received abridged advice.
- An FCA review has highlighted that many suitability reports are too long with unclear recommendations. To address this, the regulator is proposing that firms must include a one-page summary at the front of all transfer suitability reports requiring a PTS. This proposal also applies to pension conversions. This summary must include the following:
  - Charges disclosure – advisers must disclose ongoing advice and all product charges they expect to levy in the first year if a transfer or conversion goes ahead, presented in pounds and pence, alongside the charges associated with the client remaining in their current DB scheme. If a client's WPS is not used as the destination scheme, the adviser must also provide a disclosure of the charges associated with a transfer into their WPS. Any first-year contingent charges must also be presented as a percentage of the client's DB scheme income in today's terms, so that the client can see the proportion of DB income that might be given up to charges if they were to transfer.
  - The wording of the adviser's recommendation must clearly set out whether the consumer should transfer (or convert) their pension or not.
  - A statement of the risks associated with the transfer or conversion. The client must be invited to provide a signature in the one-page summary to confirm that they understand the risks disclosed to them.
  - Information about any ongoing advice service provided if the adviser proceeds with the transfer or conversion. The client must be informed that they are not required to take this service, and that they may cancel at any time. The monthly and annual charges associated with this service must also be disclosed in pounds and pence.

The one-page summary should also state whether the service provided is abridged or full advice. Where a positive recommendation to transfer or convert is made, the FCA is proposing new guidance that a firm must gather evidence that the client can demonstrate that they understand the risks to them of proceeding with a pension transfer before finalising the recommendation and keep a record of this evidence. If the client is not able to demonstrate this, or declines to sign the summary confirming their understanding, then the adviser should generally not make a recommendation to transfer.

Enabling advisers

The FCA wants to raise standards by improving the levels of knowledge and understanding of Pension Transfer Specialists (PTSs) who give or check advice on pension transfers.

- The regulator is proposing that a PTS must undertake a minimum of 15 hours CPD each year, focused specifically on pension transfer advice. This would be in addition to any other existing CPD requirements for other types of advice.
- At least five of the 15 hours must be provided by resources external to any firm that employs or contracts services from the PTS. This will ensure that a PTS is not just receiving a 'house view' of the market.

Effective regulation

The FCA wishes to establish new data collections from advice firms to improve their ability to regulate the sector. The regulator has proposed changes in the following areas:

- To create a new section of the RMAR regulatory return (RMA-M) covering data on DB and other safeguarded benefit advice.
- To amend the existing data collected on intermediaries' professional indemnity insurance cover within the existing quarterly RMA-E submission, FSA031, FSA032, and FIN-APF, so that they have better data about the PII cover of all firms that offer retail intermediation.

Technical amendments

The regulator is consulting on changes to the pension transfer definition and has set out technical proposals to clarify to firms how to apply their rules and guidance in practice. The proposed changes include:

- Clarifying and amending the TVC.
- Additional factors firms should incorporate in cashflow modelling (where used).
- Clarifying how the pension transfer rules should be applied to retirement annuity contracts.
- How to use estimated transfer values for initial advice.
- Clarifying the application of adviser charges.
- Explaining the scope of arranging a transfer.

FundsNetwork's reaction to the FCA's proposals

We understand the FCA's desire to ensure that customers get high-quality advice for critical decisions such as whether to transfer out of their defined benefit pension arrangements. This move will surely go some way to tackling some of the poor practices they have observed in pockets of the market. However, we do remain concerned that the proposals will do little to solve the equally pressing issue of lack of access to, or take-up of, financial advice by consumers who could undoubtedly benefit from the experience. Indeed, in some regards, they could even contribute to the problem. We very much hope to see these issues addressed further in the final policy statement and the forthcoming Financial Advice Market Review.

11. Retirement Outcomes Review

Summary of the FCA's Policy Statement PS19/21

Following the introduction of the pension freedoms in 2015, the FCA launched the Retirement Outcomes Review (ROR) in June 2016 to investigate how consumers and providers were responding to the new freedoms. A final report was issued in June 2018 setting out the regulator's findings and a proposed package of remedies. Following a consultative process (CP19/5), the FCA has now issued their final rules on a second tranche of remedies (PS19/21). The changes are primarily designed to help non-advised drawdown consumers who struggle to make investment decisions. These can be summarised as:

- Drawdown providers must offer non-advised consumers investment pathways.
- Drawdown providers must ensure that non-advised consumers entering drawdown who invest wholly or predominantly in cash are only doing so because this is an active decision.
- Pension providers must give consumers in decumulation annual information on costs and charges.

Here we briefly summarise the key points from the paper, although you may wish to read the full text of the Policy Statement.

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Ensuring investment in cash is an active decision 87

FundsNetwork's reaction to the FCA's proposals 88

Investment pathways

The consumers and providers to be covered by the rules

- Providers must offer investment pathways (as outlined in the sections below) to non-advised consumers when they move all or part of their pension savings into drawdown or when they transfer funds already in drawdown into a new drawdown arrangement. Consumers purchasing 'fixed-term annuities' should not be caught by the investment pathway proposals.
- For the purposes of investment pathways, a consumer is an 'advised' consumer if they are advised on how to invest all or part of their drawdown pot. When a consumer later makes another investment decision, consumers should be treated as non-advised for the decision if it is made:
  - More than 12 months after the transaction they were advised on, or
  - Within 12 months of the transaction they were advised on and they have not confirmed that their personal or financial circumstances are unchanged since they received the advice.

The FCA has amended their rules to remove the need for providers to ask the consumer whether they are advised if they have clear evidence as to whether the consumer has received a personal recommendation on the specific transaction, or has not.

The regulator does not consider the fact that the consumer is paying an ongoing adviser charge to be sufficient evidence that the consumer is being advised on the specific transaction. If a consumer who is paying for advice is approaching a provider themselves, this could indicate that they're unaware that they are paying for advice. The FCA has therefore added guidance stating that providers should tell these consumers that they are paying an ongoing advice charge and explain what that means in this context, if they wish to proceed on the basis that these consumers are advised.

- The rules on investment pathways will not apply to consumers taking UFPLS.
- Where a consumer has taken only part of their tax-free cash entitlement, and not agreed with their provider how they wish to take their remaining tax-free cash entitlement and move funds into drawdown, they should be offered investment pathways each time they move funds into drawdown.
- Firms offering drawdown to non-advised consumers should be covered by the rules and offer consumers investment pathways. This includes operators of Self-Invested Personal Pensions (SIPPs). However, the regulator has eased this requirement for small providers (as set out on page 3).

The choices that providers must offer consumers

Consumers should be shown the following objectives to help them pick a pathway solution:

- **Option 1:** I have no plans to touch my money in the next five years.
- **Option 2:** I plan to use my money to set up a guaranteed income (annuity) within the next five years.
- **Option 3:** I plan to start taking my money as a long-term income within the next five years.
- **Option 4:** I plan to take out all my money within the next five years.

The wording of the objectives is mandated (although the FCA will review the wording periodically) and there should be clear labelling on the pathway solutions.

- Investment pathways are intended to benefit some of the most unengaged consumers entering drawdown. To ensure maximum engagement, the FCA has issued a rule that limits providers to one pathway solution for each investment pathway objective (so that consumers do not have to make a further choice between investment solutions). However, the same pathway solution does not have to be offered to all consumers selecting the same investment pathway as there could be circumstances where it makes sense to offer different solutions (such as where a provider offers target-dated funds for consumers in different age ranges).
- The regulator wants to ensure that consumers do not select a pathway solution if the risk profile of the solution does not match their attitude to, or capacity for, risk. Providers must therefore describe the riskiness of each investment solution that they offer to enable consumers to make this assessment.
- The regulator does not want to prescribe in detail how providers should present investment pathways amongst the other investment options they may offer to their non-advised consumers. However, a number of requirements have been made to ensure that providers give investment pathways a prominent place in the non-advised consumer journey.
- Providers can offer investment pathways to consumers without giving a personal recommendation, although providers will want to ensure clear communications to avoid misperceptions in this regard.

The requirements for providers

- The FCA rules relating to offering pathway solutions:
  - Do not prescribe the investment solution or risk profile providers should adopt for each investment pathway objective.
  - Allow providers to offer pre-existing investment solutions for any of the investment pathway objectives as long as they meet the relevant objective.
  - Prevent providers from offering the same pathway solutions for all the objectives.
  - Require providers to label pathway solutions clearly with the name of the investment pathways objective they are linked to.
  - Prevent providers from labelling any other investments in ways that imply they are a pathway solution.
- Providers with fewer than 500 non-advised consumers ayear entering drawdown are allowed to choose to not offer pathway solutions for any of the investment pathway objectives. These providers would still be required to offer the investment pathways choice architecture but would instead have to refer consumers who select an investment pathway objective to either:
  - Another provider's pathway solutions, or
  - The MAPS (Money and Pension Service) drawdown comparator tool.

Other key elements

- The FCA has laid out product governance requirements applying to providers offering pathway solutions.
- Consumers using investment pathways must receive the following information within their annual statement:
  - A statement reminding them of the current size of their drawdown pot, in pounds and pence, and their investment pathway choice.
  - Information on the other investment pathways available to the consumer.
  - A statement reminding the consumer that they can switch their investments at any time or move into another product at any time and that they should shop around before doing so.
- If the consumer has not made any changes within five years of entering their investment pathway, or after a further multiple of five years, their provider should consider including in their next annual statement:
  - A statement reminding the consumer that five (or 10, as relevant) years has elapsed since they selected the investment pathway.
  - An enhanced prompt to the consumer to review their investment decision.
- The regulator has issued a non-exhaustive list of the areas where they consider it most important that providers keep good records.
- Providers will be given 12 months to implement these changes from the date the FCA issue their final rules and guidance.

Ensuring investment in cash is an active decision

- The FCA's rules on making cash an active decision and providing cash warnings will apply to non-advised consumers when they move funds into drawdown, or transfer funds already in drawdown to another arrangement (the regulator is continuing to consider whether the rules should also cover 'cash-like' investments).
- Providers should ensure non-advised consumers entering drawdown, or transferring assets from another fund in drawdown, only invest wholly or predominantly in cash or cash-like assets if they make an active decision to do so.
- When non-advised consumers have made an active decision to invest wholly or predominantly in cash, their provider must give them a warning about the potential risks of cash investment. This applies to all investment options, including pathway solutions.
- Consumers who remain in cash must be given a cash warning at least annually (which can be issued with the annual statement or on the policy anniversary, if desired).
- Providers should keep records that will allow the FCA to monitor compliance with their requirements.
- The implementation period for these changes is 12 months.

Actual costs and charges information

Firms need to provide information on the actual costs and charges both advised and non-advised consumers are paying for their pensions post-sale, during the decumulation phase:

- Providers of personal or stakeholder pension schemes should provide consumers in decumulation with annual information on all the costs and charges they have paid on their pension pot. If a firm does not have the information necessary to comply, it must take reasonable steps to obtain it. If, despite having taken reasonable steps, the firm is still unable to comply, the firm should provide consumers with a reasonable estimate or provide a written statement to explain what costs and charges are not included in the figure provided.
- This information should be provided to consumers in drawdown, and consumers who have withdrawn at least one UFPLS payment.
- It should include transaction costs, be aggregated, and be presented to the consumer as a pounds and pence cash amount.
- To enable some firms to use the same systems and data they currently use to comply with MiFID disclosure requirements, a particular methodology to calculate transaction costs has not been mandated.
- When disclosing actual costs and charges, firms must state whether any adviser remuneration has been paid out of the product.
- These requirements do not apply to products, such as 'fixed-term annuities', where the costs and charges of the product are built into the price.
- Firms have 12 months to implement the proposals from 1 August 2019.

Firms must provide costs and charges information within the annual statement.

FundsNetwork welcomes the FCA's final rules

The publication of the FCA's final rules on investment pathways will help with the successful implementation of investment pathways against the challenging timeline of 1 August 2020, and we believe the new measures proposed will support non-advised customers who need more structured retirement solutions to choose from.

However, investment pathways address a symptom with a number of causes – namely to ensure those seeking guidance, or advice, are able to access it. As the FCA continues to review the impact of the Financial Advice Market Review we hope to see more impactful steps taken to improve the accessibility of financial advice and to liberate the provision of guidance.

12. A summary of the FCA's current guidance and rules on pension transfer advice

A summary of the FCA's current guidance and rules

As a result of the government's pension reforms, there has been an increase in demand for advice on pension transfers. This prompted the FCA in 2018, to consult on and publish changes to how advice is given to consumers about converting or transferring safe guarded benefits. The FCA's new guidance and rules in this area came into force in April 2018 and October 2018 as contained in Policy Statements PS18/6 and PS18/20.

Here we briefly summarise the key points from both papers. We do not cover all the new policies/announcements or proposals and so we recommend that firms advising on pension transfers and those acting as pension transfer specialists read the full texts to see how they may be affected.

What's Covered?

Policy Statement 18/6: Advising on pension transfers 90

Policy Statement 18/20: Improving the quality of pension transfer advice 91

Policy Statement 18/6: Advising on pension transfers

Giving advice and assessing suitability

- All advice on the transfer and conversion of safeguarded benefits should include a personal recommendation (including where the benefit is a guaranteed annuity rate)
- The 'starting assumption' should be that a transfer will be unsuitable (the FCA decided not to change this to a neutral starting point)
- When assessing suitability, advisers should consider:
  - a) The client's intentions for accessing pension benefits
  - b) The client's attitude to, and understanding of the risk of giving up safeguarded benefits for flexible benefits
  - c) The client's attitude to, and understanding of investment risk
  - d) The client's realistic retirement income needs including how they can be achieved, the role played by safeguarded benefits in achieving them and the consequent impact on those needs of a transfer, conversion or opt-out (including any trade-off)
  - e) Alternative ways to achieve the client's objectives instead of the transfer, conversion or opt-out (this may include only giving up some safeguarded benefits)
- If an adviser cannot get the necessary information to assess suitability, they must not make a personal recommendation. For example, this could be income needs in retirement for a younger client
- A Pension Transfer Specialist (PTS) should go beyond just checking the numerical analysis. They should:
  - a) Check the entire advice process and consider whether it is sufficiently complete
  - b) Confirm that the personal recommendation is suitable
  - c) Inform the firm in writing that they agree with the advice, including any recommendation, before the report is given to the client. This means that any disagreements between the PTS and the adviser must be settled before the client is given the suitability report

Analysis to support advice

- Since 1 October 2018 firms have been required to carry out an Appropriate Pension Transfer Analysis (APTA). The FCA believe the pension environment has shifted significantly in recent years and this new minimum analysis requirement is designed to address this. They also believe that too much focus has been on the TVAS critical yield figure in the past and a more rounded assessment of suitability is required
- The FCA have not provided detailed rules on the elements of an APTA. However, they set out the following as a minimum expectation within the original Consultation Paper (CP17/16):
  - a) An assessment of the client's outgoings and therefore potential income needs throughout retirement
  - b) The role of the ceding and receiving scheme in meeting those income needs, in addition to any other means available to the client
  - c) Consideration of death benefits on a fair and consistent basis
  - d) A mandatory Transfer Value Comparator (TVC)
- Changes to the handbook were added in relation to the APTA, including:
  - a) Requiring advisers to consider the impact of tax and access to state benefits
  - b) Stating that the APTA must consider a reasonable period beyond average life expectancy
  - c) Requiring advisers to consider the trade-offs that may occur by prioritising differing client objectives
  - d) Requiring advisers to have regard to the likely pattern of benefits that might be taken from both the ceding arrangement and the proposed arrangement
  - e) Guidance on considering safety nets (the Pension Protection Fund and Financial Services Compensation Scheme) that cover both the current and receiving schemes in a balanced and objective way
  - f) Guidance that if information is provided on scheme funding or employer covenants, it should be balanced and objective

- A mandatory Transfer Value Comparator, which replaces the TVAS critical yield, is required for all transfers (except those where the client has less than 12 months to their normal retirement date or the safeguarded benefits are guaranteed annuity rates only)
- The TVA should show in graphical form:
  a) The cash equivalent transfer value (CETV) offered by the DB scheme
  b) The estimated value needed to replace the client's DB income in a DC environment assuming investment returns that are consistent with the client's attitude to investment risk and that they purchase an annuity
- The calculation of the TVA needs to include:
  a) Where relevant, a projection of the ceding scheme benefits to normal retirement age
  b) The estimated cost of purchasing those benefits using an annuity
  c) Discounting the figure in (b) by the appropriate rate of return and charges to determine the estimated value at the calculation date
- The FCA have defined the assumptions to be used when calculating a TVC:
  a) The annuity cost should be determined in accordance with COBS assumptions (with a 4% annuity charge)
  b) The investment growth/discount rate will be based on a risk-free return using gilt yields (UK FTSE Actuaries Indices). Firms should assume product charges during accumulation of 0.75%
- Details have been given on a number of financial and demographic assumptions to be used when preparing an APTA or a TVC, such as the annuity interest rate, mortality rates and growth rates, and that charges should be incorporated into the analysis (except where an adviser charge is payable by an employer or if the advisers charge is non-contingent on the outcome i.e. still payable whether the transfer proceeds or not)
- Where third-party software is used, the adviser is still responsible for the recommendations they provide and the supporting analysis. Firms therefore need to ensure that any third-party software is fit for purpose. Regarding free software offered by providers, the FCA have stated "we consider it is unlikely that providing or accepting free TVA or APTA software would fall within the narrower definition (acceptable inducements under MiFID II) and so should not be used"

Other issues

- Pension opt-outs:
  a) There is a requirement for advice to be given or checked by a Pension Transfer Specialist
  b) Record keeping should be consistent with the provisions of COBS 19.1
  c) The APTA and TVC requirement will not be extended to opt-outs of safeguarded benefits. Opt-outs that do not involve safeguarded benefits will also be excluded from these provisions
- Overseas transfers – the FCA consider that their guidance (the need for a personal recommendation, an APTA, etc.) can accommodate overseas transfers
- Streamlined advice – the FCA stated that this is unlikely to be appropriate for pension transfers

Policy Statement 18/20: Improving the quality of pension transfer advice

Standards to meet before giving advice

- All Pension Transfer Specialists (PTSs) must hold the Level 4 RDR qualifications for advising on investments before they can advise on or check pension transfer advice. Holding this qualification, as well as the PTS qualification, will ensure advisers have sufficient knowledge to assess the suitability of a transfer, including the risk, returns and charges of the proposed scheme and the underlying investments
- A PTS should hold the new qualification as soon as practically possible and by no later than 1 October 2020. There will be no automatic transition – to continue practising after this date a PTS must have achieved the investment qualification
- The rules will continue to permit an adviser who does not meet the PTS requirements to provide pension transfer advice, as long as their advice is checked before the client is given a suitability report
- Firms are responsible for reviewing the competence of their employees on a regular basis and the FCA believe it is very important for a PTS to keep up to date with current thinking and market trends. Firms therefore need to act to ensure their staff remain competent for their role, particularly where an adviser has not been involved in pension transfers for some time or only advises on occasional cases. The FCA is therefore giving further thought to the question of minimum CPD requirements

- The Appropriate Exam Standards for the PTS qualification (ApEX 21) have been revised to reflect the FCA's updated rules and guidance, as well as more widespread changes to the pensions environment, such as the introduction of the pensions freedoms
- The FCA decided not to change the definition of a pension transfer at this time (the proposal had been to include reference to safeguarded and flexible benefits). The regulator is investigating other ways to simplify and clarify the definition.

Preparing to give advice

- When advising on a pension transfer, the advice must take account of the proposed destination of the transfer funds (both the proposed scheme and investments)
- The rules do not prevent two separate advisers providing the transfer advice and the advice on the proposed receiving scheme and its investments. However, the FCA expect the two advisers to work with the same information about the client and have robust processes in place to ensure that this happens. Both parties should therefore work together to:
  a) Collect the necessary information to inform the transfer advice and associated investment advice

  b) Undertake risk profiling which assesses the client's attitude to transfer risk and investment risk

  c) Recognise that the investment advice should consider the impact of the loss of any safeguarded benefits on the client's ability to take on investment risk.
- When a firm operates a two-adviser model, they should make this arrangement clear to the client. The client needs to understand the roles of both advisers, their respective charging structures and the complaints process
- The FCA's rules and guidance do not prevent firms from advising self-investors (clients who choose their own proposed schemes and investments). Where this is the case, the FCA have the following expectations:
  a) Advisers should take account of the proposed destination of the funds (the client needs to be clear that they should provide the necessary information on the scheme and its underlying investments). The adviser must have a clear view on the destination scheme and the long-term investment strategy – this is so they can take account of the risks, expected returns and charges which support the pension transfer advice

  b) Where a transfer is unsuitable in principle, but not specifically because of the proposed destination, the adviser should explain the basis for their recommendation

  c) Where a transfer is unsuitable specifically because of the proposed destination, the adviser should explain that a transfer may be suitable if the client selects a different destination for the funds

  d) If the adviser gives an opinion on how to amend the proposed destination, this is likely to be investment advice (Perimeter Guidance (PERG) 8.28.1G)

  e) Where there is uncertainty about the client's future intentions or the relevant information about particular asset classes is not available, an adviser should not advise on the transfer.
- The FCA intends to proceed with their proposed perimeter guidance on triage (where a firm provides information and holds an initial conversation with a potential client so that they can decide whether they want to take advice).This clarifies the boundary between advice and guidance – the regulator has found some forms of triage stray into providing a personal recommendation rather than just giving generic information. The perimeter guidance on triage came into force on 1 January 2019:
  a) If triage is to be a non-advised service, it should be an educational process so that the prospective client can decide whether to proceed to regulated advice. Firms can achieve this by providing generic, balanced information on the advantages and disadvantages of pension transfers

  b) If the firm wishes to avoid giving advice, it should not comment on whether the client should consider a transfer based on any information about the client's personal circumstances (should the client pass this information on during the triage stage)

  c) The FCA do not consider that re-stating the starting assumption of unsuitability is giving advice, if given as information about the FCA's view on pension transfers

  d) The regulator considers it good practice for firms to keep records where they have provided triage

Providing advice

- The FCA introduced new requirements regarding the assessment of a client's attitude to transfer risk. So, when considering a client's attitude and understanding of giving up safeguarded benefits for flexible benefits, an adviser should take the following into account:
  a) The risks and benefits of both staying in the safeguarded benefit scheme and transferring to a flexible benefits scheme

  b) The client's attitude to certainty of income throughout retirement

  c) Whether the client is likely to access funds in flexible benefits in an unplanned way and the impact this would have on sustainability of the funds over time

d) The client's attitude to any restrictions on their ability to access funds in a safeguarded benefits scheme

e) The client's attitude to and experience of managing investments themselves or paying for them to be managed in a flexible benefit scheme.

In addition, the regulator has stated that clients also need to be told about other risks such as longevity risks and investment risks. Insolvency risk should also be covered in a balanced way so that any client biases and misconceptions are managed, for instance regarding the benefits provided by the Pension Protection Fund:

- If a firm uses a risk profiling tool or software to assess a client's attitude to the risks detailed above, they should check that the tool or software takes these factors into account. If not, then the firm should determine the client's attitude to transfer risk in other ways
- When a firm asks a client about their attitude to transfer risk, they should communicate in a way which is fair, clear and not misleading
- The regulator confirmed that firms should provide:

a) A suitability report regardless of the outcome of the advice (one should be issued even where the recommendation is not to transfer or convert)

b) An advice confirmation for both positive and negative recommendations.

- The FCA confirmed the pension increase assumptions to be used for the Transfer Value Comparator (TVC). Full details of the changes can be found within PS18/20.

Charging structures associated with advising on pension transfers

Within its 2018 consultations the FCA sought views on a number of questions relating to different charging structures used in pension transfer advice (they did not propose rule changes). A particular focus was on contingent charging, where an adviser is only paid if a transfer takes place or where they receive a significantly lower amount where a transfer does not take place.

In the feedback it published in October 2018, it summarised the pros and cons of a ban and said responses to the consultation highlighted the "complexities and interlinked issues that need to be worked through and considered". As a result, the FCA did not introduce a ban on contingent charging and said it "needs to carry out further analysis of the issues". In particular, there was a lack of evidence linking contingent charging to unsuitable advice and bad outcomes.

Subsequent to this, the Work and Pensions Committee have set up an inquiry to look at how pension transfer advice is charged for where is called for evidence from consumers and related professionals. The FCA is expected to consider the matter further and issue further information in the summer of 2019.

Important information

This chapter provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations.

This chapter represents a summary of our understanding of the relevant regulations at the date of its last review (July 2019).

Regulations and guidance are often subject to change and may change in future. Individuals should check that rules and regulations have not changed.

13. FCA Investment Platforms Market Study

In July 2018, the FCA issued an Interim Report looking into the investment platform market in the UK (MS17/1.2). This Market Study looks at how competition is developing in this growing sector and puts forward how the regulator would like the market to develop.

It includes a number of interim proposals to improve certain aspects of the market which, in their opinion, could work better. As such, the majority of the study focuses on these areas of potential improvement. FundsNetwork welcomes this report and it is encouraging to see that the regulator recognises that the platform market appears to be working well in many respects, with high customer satisfaction.

Here we briefly summarise the key points from the study, although were recommend firms read the **full text** to see how they may be affected by potential remedies which could be implemented at the conclusion of the process. MS17/1.2 contains an Executive Summary on page 3 and is seeking views on the areas highlighted on pages 95-107 of the report. Interested parties, including platforms and advisers who use their services, had until 21 September 2018 to comment on the FCA's interim findings and proposals.

What's Covered?

FCA key findings and proposed remedies 95

The FCA's key findings and proposed remedies

The market appears to be working well in many respects for both advised and non-advised consumers

- Platforms are popular with investors and customer satisfaction is currently high
- Users of direct-to-consumer (D2C) platforms care about price and other features such as the product range and ease of use. Non-advised consumers who pay more for their platform tend to get greater functionality on average
- Advised platforms compete by offering services to advisers but are paid for by consumers. Most of these services directly or indirectly benefit the consumer, although there are some exceptions
- The financial performance of platforms does not suggest widespread competition concerns in the market.

Competition is not working well for five groups of consumers:

1. Consumers who would benefit from switching platform can find it difficult to do so

- The switching process for investors is complex and time consuming. For non-advised consumers who have switched over the last three years, the majority found the process easy. However, 11% experienced some difficulty during the process. A further 7% of non-advised consumers who tried to switch failed to do so because of the time involved, the complexity of the process and exit fees. About a quarter of advisers surveyed felt it is difficult – or very difficult – to switch
- The time it takes to switch between platforms varies considerably. It is generally completed in a couple of weeks to a few months, but can take longer
- While advisers update their platform lists for new investments over time, not many switch existing investments as the process is complicated. This means that even if there are better options which advisers use for new clients, they rarely switch existing investments across platforms
- Almost 50% of advisers said they were likely to charge clients an extra fee for switching in addition to their ongoing fee. This can cancel out the potential benefits of lower platform fees and act as an additional barrier to switching
- Advisers who charge an additional fee for switching do so because they consider it a full advice event which requires a suitability report. While the FCA recognise that advisers should be fairly paid for their work, it is not clear to them why meeting suitability requirements to switch platform should outweigh the benefits of switching.

Proposed remedies and views sought

- The FCA believe the current industry initiative which is seeking to improve the switching process and reduce transfer times should, at a minimum, result in the following:
  - The introduction of a maximum timescale for each step in the re-registration/transfer process
  - Clear communication to customers from the receiving provider at the start of the switch. This should detail the transfer process, timelines and a point of contact for questions and complaints
- They also think a further positive step would be for the industry to publish data on transfer times so that comparisons can be made. This will allow pressure to be put on platforms to make improvements
- The regulator is also considering banning exit fees and improving switching between share classes
- The FCA are seeking views on how they can reinforce the industry initiative, such as using minimum standards to assess whether firms are complying with the rule which requires re- registration requests to be made 'within a reasonable time and in an efficient manner'
- They are also considering issuing new guidance to clarify their expectations for advisers charging for switching platforms.

2. Non-advised consumers who are price sensitive can find it hard to shop around

- It is difficult for consumers to choose a D2C platform on the basis of price. Most platforms have a large number of fees, different pricing structures and ways of setting prices
- The most price-sensitive consumers do not appear to be choosing the cheapest platforms more often that other consumers
- MIFID II cost disclosure provisions should help consumers compare the total cost of investing but there is scope for further improvement.

Proposed remedies and views sought

- The FCA are conducting a supervisory review to assess whether providers and distributors are providing the charges information required by MIFID II and PRIIPs
- They are not proposing any additional cost and charges disclosure rules at this stage but wish to see innovation from platforms in the way they present MIFID II and charges data
- Alternative options include requiring platforms to give intermediaries more data on platform charges and performance.

3. Consumers (and their advisers) using ready- made/model portfolios may have the wrong idea about the risk-return levels they face

- The information platforms provide about similarly- labelled ready-made/model portfolios makes comparison difficult. Similarly-labelled model portfolios also expose investors to very different underlying assets and volatility in returns
- The fees for model portfolios vary significantly.

Proposed remedies and views sought

- The FCA recognise that the issues they have identified with in-house model portfolios might also apply to those provided by wealth and asset managers and more to particular types of platform. They are doing further work to assess the scope of these issues
- Depending on what they find from their research, the FCA could explore measures to help consumers make better choices between model portfolios. This could include, for example, firms to use standard terminology to describe their strategy and asset allocation, as well as introducing the same disclosure requirements for model portfolios that currently apply to funds.

4. Non-advised consumers on D2C platforms may be missing out by holding too much cash

- Consumers using D2C platforms hold large cash balances (8.8% of assets under management compared to 3.9% for adviser platforms in 2017)
- Even where consumers make a conscious choice to hold cash, they may not realise the cost of doing so because of platform fees, potential lost investment returns or foregone interest.

Proposed remedies and views sought

- The FCA will assess if existing rules on disclosure go far enough and whether further rules or guidance is required to ensure consumers are making informed decisions.

5. 'Orphan clients' who are no longer receiving advice face higher charges and lower service

- Orphan clients often have limited ability to access and alter their investments on adviser platforms and so are paying for functionality they cannot use
- Some platforms charge orphan clients extra fees on top of their pre-existing platform charges.

Proposed remedies and views sought

- The FCA are considering the following measures:
  - Tackling price discrimination between orphan and existing clients
  - Requiring platforms to have a process in place to switch these customers to a more appropriate proposition
  - Requiring adviser platforms to check, if there is no activity after a year, that their customers are receiving an advice service and to inform the FCA of orphan clients who are still paying for advice they no longer receive.

Certain commercial practices may dampen competition on fund discounts

- The FCA recognise that consumers benefit when platforms negotiate discounts on investment charges from fund managers. However, discounts are concentrated on the largest platforms and, as to be expected, this potentially makes it harder for smaller platforms to compete
- Some arrangements between platforms and asset managers can disincentivise the asset manager from offering lower fees on other platforms. These include explicit contractual clauses relating to charges, time-limited exclusive discounts in return for the marketing of new funds and schemes to offer benefits to fund managers in return for deals on pricing.

Proposed remedies and views sought

- The FCA is seeking views from stakeholders on the positive and negative impact of pricing arrangements between platforms and asset managers.

Platforms could improve the presentation of fund charges to consumers and advisers, which would strengthen competition between asset managers

- Platforms generally do not show advisers the individual and weighted average fund charges their clients are paying when they view client accounts. This means platforms are not facilitating advisers' ongoing assessment of whether the client is receiving good value for money
- Adviser platforms could help advisers monitor whether clients are receiving good value for money from their portfolios by showing the fund charges their clients are paying when they view client accounts
- Platforms could make fund charges more salient, which will encourage competition between asset managers.

Proposed remedies and views sought

- The FCA have conducted research that suggests presenting charges in a clear, understandable and prominent way can increase the attention investors pay to charges. They would like platforms to consider this research when they decide how to present charging information to customers so that they can make informed choices between products
- The regulator will assess how the industry is innovating in this area before introducing further remedies to improve the salience and comparability of fund charges.

Potential areas of non-compliance with existing rules

- Some advisers use services, such as education and training courses, white labelling, bulk rebalancing and model portfolio management tools, which the FCA suggests are likely to benefit them but not necessarily their clients. The FCA considers that some of these services are likely to be 'non-monetary benefits' and so are likely to be caught by the FCA's inducement rules
- Advisers need to demonstrate that these benefits are acceptable minor non-monetary benefits (because, for example, they enhance the quality of the service to the client) and will not impair the firm's duty to act in the client's best interests
- Most D2C platforms offering stockbroking services do not have robust 'best-execution' monitoring and many make it difficult for clients to know when their trade will be placed.

Proposed remedies and views sought

- Both platforms and advisers should consider whether any non-monetary benefits comply with the FCA's inducement rules
- D2C platforms offering stockbroking services can do more to consistently achieve and demonstrate best-execution results for their customers.

The regulator also flagged within the study that:

- While platform fee discounts in exchange for volume of business from advisers benefit the end consumer, they may also deter advisers switching or considering alternative platforms which may be better for consumers
- Financial arrangements to attract or retain advisers appear to be limited, but any such monetary arrangements need to comply with the applicable rules in COBS
- Platform tools and services, such as charge collection services, reporting and management information and CGT calculators, have tangible benefits for advised clients. However, the FCA are unclear on what benefit clients receive from other services, such as CPD/training, model portfolio management, bulk rebalancing/switching and white labelling
- The provision of training is likely to be a non- monetary benefit to advisers. However, training on the benefits of specific financial instruments or investment services can be provided by a platform and received by an adviser in compliance with the FCA's rules
- The provision of a white labelling service can, in principle, constitute a non-monetary benefit. While each case is different, the FCA believe that white labelling is unlikely to improve the quality of service to the end client. It can also impact on a firm's choice of platform if they want to switch
- Model portfolio management and bulk rebalancing and switching capabilities make processes more efficient for advisers. However, this doesn't generally result in lower adviser charges. These services can also act as a barrier to switching platforms
- The FCA stated that it is clear advisers benefit from using platforms. However, without further investigation of the adviser market, they cannot conclude whether these efficiency benefits are being passed on to consumers.

14. Pension death benefits and tax

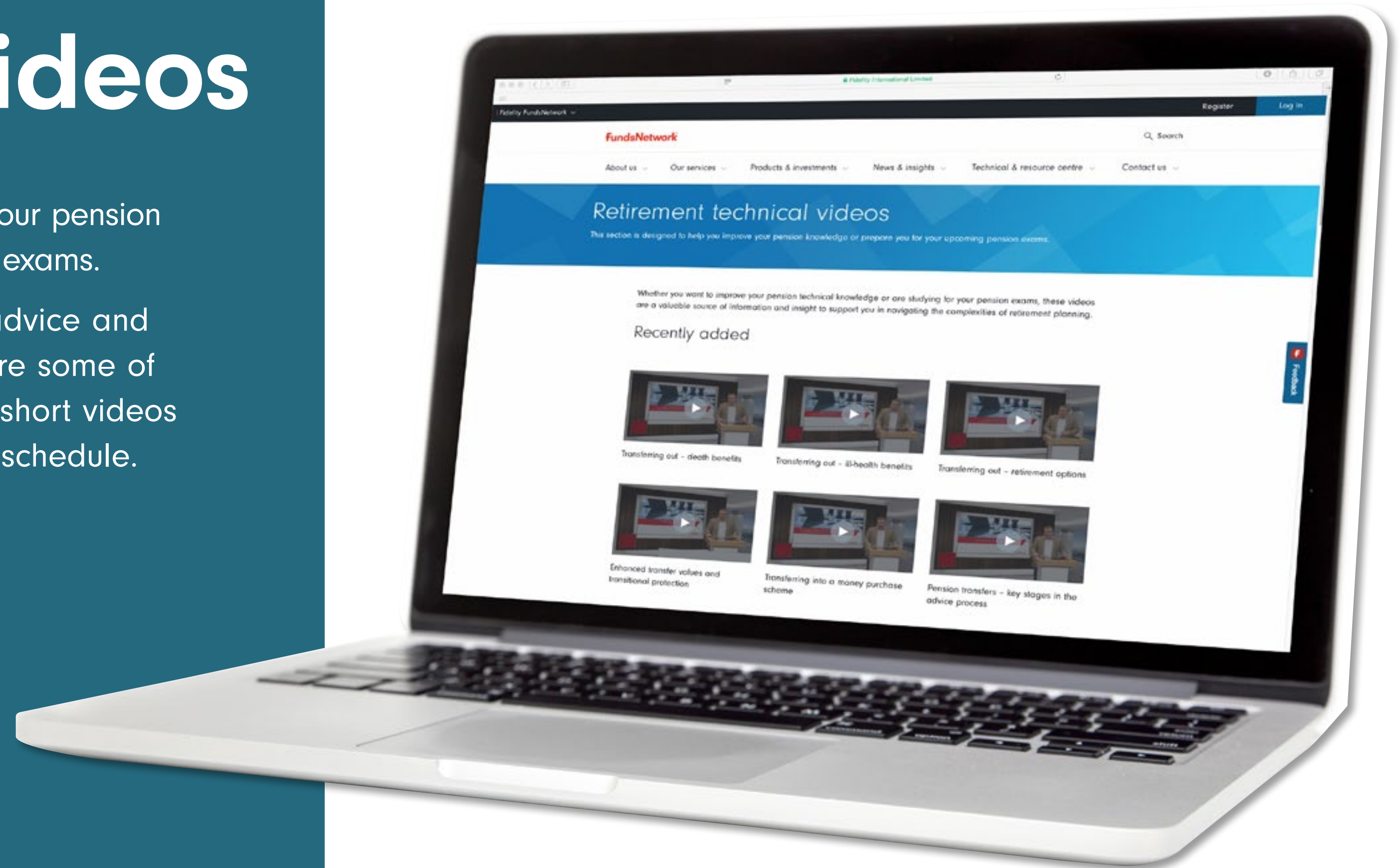
Pensions can now play a far more dynamic role in terms of succession and inheritance tax planning. Paul Kennedy, Head of Tax and Trust Planning, explores both the structure and taxation of death benefits from money purchase pensions.

To view this video please click here

15. Retirement technical videos

These videos are designed to help you improve your pension knowledge or prepare you for upcoming pension exams.

The lifetime allowance, define benefit transfer advice and calculating the cash equivalent transfer value are some of the most popular subjects. Check our library of short videos and simply dive in and out to fit with your busy schedule.



To view our retirement technical videos please click here

Helping you with your due diligence

Everything you need to know about our market-leading retirement solution in one handy place.

FundsNetwork™

1. Choosing the best retirement solution for your business

In a world of pension flexibility and freedom, selecting the right pension product for your firm is more important than ever before. Since its introduction in 2013, our pension has grown significantly and has benefited from a continuous programme of enhancements. We believe it offers you a flexible solution for your clients – both pre- and post-retirement.

In order to help you in your due diligence process, we have produced this document covering the reasons why you can recommend our pension to your clients. It complements the more detailed Product Specification which is also available on our website.

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Financial strength and private ownership

When you recommend our pension to your clients, you have the reassurance of knowing that it is offered by one of the largest platforms in the UK. As a pioneer in this field, we have over 19 years' experience in providing the products, infrastructure and support your firm needs to work efficiently, save time and reduce costs.

- Today FundsNetwork are trusted with the administration of over £36 billion of clients' assets[1]
- We are an experienced administrator of retirement solutions and have been operating in the Defined Contribution (DC) pensions market since 1994

We are fortunate to be owned and backed by Fidelity International – a private, global asset management company which has demonstrated its commitment to the sector by establishing investment platform businesses in many markets around the world.

With such experience, scale and support, we have committed to a multi-year investment programme. This is designed to enhance our FundsNetwork proposition, services and usability here in the UK even further and our pension is at the heart of this development. We are also passionate about delivering an ever-improving experience to all our clients. To achieve these aims, we will continue to dedicate ourselves to developing new services that will help advisory firms achieve their business goals now and in the years ahead.

About our Pension

Scheme structure

The pension is a trust-based pension. Financial Administration Services Limited act as the scheme administrator and FIL SIPP Trustee (UK) Limited is the scheme trustee.

Within the pension a client may have a pension savings account (or uncrystallised account) into which all their regular and single payments will be paid. Depending on the benefits they decide to take, they may also have one or more than one pension drawdown accounts. Each of these accounts will have a different account number.

Cash may be held within each pension savings account and pension drawdown account. These are not designated bank accounts. All transactions will filter through the cash within each account. This does not necessarily require maintenance as natural dividends from funds can flow into cash within the account to offset charges or drawdown income.

Contribution levels

Your clients can start contributing to our pension from the following amounts, which can be accepted from the client themselves, their employer or a third party:

- Regular – £50 gross a month
- Lump sum – £1,000 gross
- A pension transfer – £10,000
- A pension re-registration – £50,000

Once an account has been opened, a client can make top ups from:

- Regular – £50 gross a month
- Lump sum – £1,000 gross

For drawdown arrangements the minimum amounts are as follows:

- To open a flexi-access drawdown account, including immediate drawdown – £50,000
- Additional crystallisations – £1,000
- Additional designations into existing capped drawdown arrangements – £1,000

Your clients can stop, restart, increase or decrease their contributions without penalty or charge whenever they wish (subject to the minimum opening account limits).

[1] Source: Fidelity as at 30 June 2019

Pension transfers

Your clients can transfer most existing pensions to us – our only requirement is that the value of a cash transfer should exceed £10,000. The assets in the existing pension can be sold and the proceeds transferred to us as cash.

To make the transfer process as quick and simple as possible, we use the Origo Transfer Service to conduct the transfer for you. This means there is less paperwork for you to complete and clients are not out of the market for a significant amount of time. If the funds in the existing pension are available on our Platform, you also have the option of moving the pension into the same funds through the re-registration process (as long as the previous provider uses the Origo service). The minimum transfer value is £50,000 for re-registrations.

You can monitor the progress of a client's inbound pension transfer by running our 'Pension Transfer Status' report using our online 'Reporting Services' facility. This also lists whether any documentation is required to complete the process.

Drawdown to drawdown transfers

We can also accept transfers from pension schemes already in drawdown. Each crystallised pension which is transferred to our pension will be held in a separate account. You can move your clients' existing drawdown accounts to us through an online process. These can be completed without the need of a client signature.

Immediate drawdown

Clients are able to enter into drawdown immediately following the transfer of a pension to us. Transfers for immediate crystallisation can be arranged online.

Charging structure

Our low charging structure is designed to be as simple and transparent as possible:

- No set-up or annual administration charges
- No annual administration charges for income drawdown
- A Service Fee of just 0.25% a year (charged monthly in arrears)
- An Investor Fee of £45 a year (£22.50 collected every six months in advance)[2]
- No charges for transferring out.

All charges will be paid from cash within the pension. If there is insufficient cash available, we will sell some of the investments, and we will follow your choice wherever possible. After that other investments may be sold, starting normally with the largest investment in the account. We will try not to sell investments that carry dealing charges like exchange-traded investments, unless they are the only investments held.

Investment options

Our investment range provides you with extensive choice whether a client is building their pension pot or taking benefits in retirement:

- You can select from over 5,000 investment options from more than 140 providers covering all the major asset classes
- Our range includes a wide selection of low-cost passive and multi-asset investments
- You can also choose from the UK's most popular investment trusts, ETFs and company shares
- Cash can be held within each pension account (this can be used if a client wishes to switch some or all of their pension savings into cash for tactical or strategic reasons)

This range is designed for all adviser investment models, whether you construct bespoke portfolios, use model portfolios, utilise a Discretionary Fund Manager or use a centralised investment proposition.

You can change investments at any time.

Model portfolios

Our Model Portfolio Centre allows you to create bespoke portfolios of up to 30 investments, taking into account the client's attitude to risk and whether they require growth or income. The portfolios can be set up for your entire firm to use or can be tailored for individual adviser or client requirements.

A rebalancing tool is also available which can be used on all client accounts once they are assigned to a portfolio. This allows you to re-adjust client portfolios online in a timely manner in order to meet changing needs or goals or to react to market volatility. You have the option of rebalancing individual client portfolios or bulk rebalancing. A cash option is available within pension portfolios.

[2] The Investor Fee will only be deducted from the pension if it is the only sole account held by the client.

Adviser fees

Our Adviser Fees service has a number of different options to suit your business. You can take:

- Initial fees on single and regular contributions and cash transfers
- Ongoing fees
- Specified (one-off) fees
- Fees as either a percentage or a fixed monetary amount

Adviser Initial Fees can also be applied in the event of a crystallisation event. Any such fee will be applied on the crystallisation value after any pension commencement lump sum is paid out.

We collect your fees on your behalf and make a consolidated payment to your bank account once a month. Adviser fees will also be paid from cash within the pension. If there is insufficient cash available, we will sell some of a nominated investment if one exists. After that other investments may be sold, starting normally with the largest investment in the account. Again we will try not to sell investments that carry dealing charges like exchange-traded investments, unless they are the only investments held.

Management information

Our Reporting Services facility enables you to find data and client information quickly and through a simple online process. Each report is designed to help you manage your business more efficiently.

The 'Pension Transfer Status' report, for example, allows you to view and track the status of all in-bound client pension transfers from other providers. The report also identifies whether any documentation is still required to complete the transfer. Other reports available for our pension include:

- Holdings – full reporting of all client holdings
- Transactions – lists details of recent transactions to enable you to check, for example, charges and fees
- Adviser Fee payments – to support the payment and reconciliation of your fees
- Adviser Fee rates – lists all client accounts set up with an ongoing fee, at what rate and where the deductions will come from
- Portfolio valuations – an overview of your total client holdings
- Client list – details all current clients and the number of active accounts held
- Fund availability – lists all funds currently available on FundsNetwork
- Agency list – details all branches that are linked to a unique adviser number (UAN)
- Web access – enables you to keep track of users set up under an agency number and ensure that they have the correct permissions
- Regular Savings Plan – allows you to track how many payments have been made, the current amount and when the next payment is due

You can specify which reports you receive and their frequency. They are compatible with most database and spreadsheet programs. The reports are held on a secure site to ensure your clients' data remains confidential.

For more details on our management information reports, please download our 'Reporting Services' user guide

Post-retirement options

Withdrawals

Typically from age 55, all clients who have taken advice have the following options for making withdrawals from their pension. They can also use their pension pot to secure a guaranteed income on the open market or withdraw the whole amount as cash.

Income drawdown

Flexi-access drawdown is available to all pension clients. They are able to take unlimited withdrawals up to the maximum value of their pension plan. Income can be taken as one-off, monthly, quarterly, half yearly or annual payments.

We also support clients with existing capped drawdown arrangements as long as they remain within the income limits. Clients can request to convert their arrangements to flexi-access drawdown with no additional costs.

We make no additional annual administration charges for clients in income drawdown above the standard platform fees.

Pension Commencement Lump Sum (PCLS)

Clients can take 25% of the amount being crystallised from their pension as a tax-free lump sum. Clients with protected tax-free cash rights may be able to take a higher percentage.

Uncrystallised Funds Pension Lumps Sums (UFPLS)

Clients also have the option of taking uncrystallised funds pension lump sums from our pension. The first 25% of every withdrawal is tax free.

Phased drawdown

Your clients can also choose to enter into phased drawdown where their pension pot is crystallised in tranches. If they select this option, their pension can be divided into separate segments and the client can draw upon these segments over time as and when required. In order to phase, or drip feed into drawdown, this is completed by partial crystallisations which can all be processed online.

Small pots

Clients are also able to take advantage of the rules relating to small pension pots. If their pension is valued at no more than £10,000, the whole amount can be withdrawn as a lump sum (assuming no more than two personal pension pots have previously been taken in this way). The first 25% of the lump sum will be tax free.

Taking a small pot does not trigger the client's Money Purchase Annual Allowance.

Investment options

Our investment range with over 5,000 options is available to clients who stay invested post-retirement. Options include a wide range of income investments including bond, equity income and multi-asset income funds from a broad range of providers. It is also possible to hold cash within a pension account.

Adviser fees

The full range of fee options are available to you when your clients stay invested post-retirement. This includes ongoing fees and specified (one-off) fees where advice is given but no new money is invested.

Flexible options on death (or in ill health)

The death benefits payable from a pension will depend on the client's age when they die. Payments are at the trustee's discretion, although they will carefully take account of the client's Expression of Wish form. We offer flexible death benefit options, including nominee's drawdown and our Expression of Wish form includes nominee options.

Where the client is under the age of 75

The remaining pension account value can be:

- Paid out as a tax-free lump sum (subject to the Lifetime Allowance)
- Used to pay out tax-free income withdrawals to the beneficiary
- Used to offer a combination of the above

Where the client is over the age of 75

The remaining pension account value can be:

- Paid out as a lump sum subject to the beneficiary's marginal rate of income tax
- Used for income withdrawals, which will be taxable at the beneficiary's marginal rate
- Used to offer a combination of the above

The above descriptions apply where death benefits are paid or a designation is made within two years of us being notified of the customer's death. Where benefits are paid or a designation is made after two years of us being notified, different conditions will apply.

Payment of serious ill health lump sum

If a client is suffering from a serious health condition, they may commute any pension held under the scheme and receive the entire benefit entitlement as a lump sum. This is possible where specific criteria are met and the condition is verified by a recognised health professional.

The Pension – Expression of Wish and Nomination Form

An Expression of Wish and Nomination Form and a helpful guide on its use can be downloaded from the 'Help & support' area of our website, once you have logged in.

Platform integration

The pension is fully integrated into our platform. This means you can use all the platform's features and tools when administering your clients' pension accounts, saving you both time and money. For example, you can conduct all the following tasks online:

- Produce pre-sale and post-sale illustrations
- Buy and switch pension investments whenever you wish
- Manage income instructions for drawdown accounts
- View client pension holdings alongside all their other investments
- Create your own model portfolios through our Model Portfolio Centre
- Ensure portfolios stay in line with client goals by using our rebalancing tool
- Analyse client holdings with Portfolio X-Ray™

The pension also provides access to comprehensive management information (please see page 104 for more details).

Support for practitioners

Literature and sales materials

A full range of supporting product literature is available for our pension. This includes the following items which are available for download from our website:

- Adviser Guide – an introduction to our pension
- Client Guide – covering all your clients need to know about our pension
- Product Specification – the detailed information on investing and taking benefits from our pension
- Product Summary – the key information at a glance
- Disclosure materials such as the Key Features Document and Pension Client Terms
- Application forms where applicable
- Withdrawal Options factsheet – outlining the features of the various withdrawal options

We also support you in your promotional campaigns by providing suggested wording for marketing letters to clients. These paragraphs summarise the benefits of savings within a pension as well as highlighting the many compelling features of our pension. You can find these paragraphs in the appendix of this document.

Many of these items are also available in pre-printed form. Simply click here to download our support material.

Technical support

Our website provides an array of insightful material to support you in navigating the complexities of retirement planning and the more complex areas of pensions. These include videos and factsheets on areas such as pension death benefits and tax and the tax relating to pension withdrawals.

We also provide a comprehensive range of videos to support individuals either studying for pension exams or who simply want to build their pension knowledge. Each video covers the learning outcomes from the CII exam syllabuses.

You can find all our support materials here.

Events and seminars

Our practitioner support also embraces a nationwide event programme covering issues such as tax and pension planning. We are an endorsed CPD provider and advisers attending our seminars will receive structured CPD accreditation.

Other support

At FundsNetwork our focus is on providing first class customer service. We always aim to be within easy reach and we want to make sure you get the support you need quickly and easily.

Our professional, highly-qualified team includes:

- **Regional Sales Managers and Sales Executives** – supporting key relationships with their day-to-day requirements to support their firms' and their clients' needs.
- **Paul Squirrell, National Pensions Sales Manager** – Paul joined FundsNetwork in December 2007 from Scottish Widows where he was a Sales Manager working mainly in the employee benefits sector. Previous to this, he worked as an Independent Financial Adviser in the Suffolk area. Paul has over 28 years' experience working in UK Financial Services and is qualified to QCF level 6.
- **Donald Manning, Pension Sales Manager** – Donald joined FundsNetwork from Royal London where he was a Pension Sales Consultant working with IFA firms, mainly in the employee benefits sector. He has over 30 years, experience working in UK Financial Services and is qualified to Diploma status.
- **Paul Kennedy, Head of Tax and Trust Planning** – Paul has over 20 years' experience in the financial services industry and joined FundsNetwork in 2007 from the Prudential, where he spent three years as Taxation and Trusts Manager. He spent three years at Norwich Union International as Head of Technical Support, and prior to this held various positions within a number of advisory firms. Paul holds an Honours degree in Law from the University of East Anglia, Norwich School of Law and is a non-practising qualified barrister.
- **FundsNetwork Retirement Solutions Team (available on 0800 902 902 between 8.30am and 6pm on any business day)** – a dedicated telephone team supporting our comprehensive range of retirement and tax planning products.
- **FundsNetwork AdviserLine (available on 0800 41 41 81 between 8.30am and 6pm on any business day)** – our Customer Account Executives will be pleased to assist you with any queries relating to your clients' accounts, general web support and any client-related questions where you are unable to find the answer online.

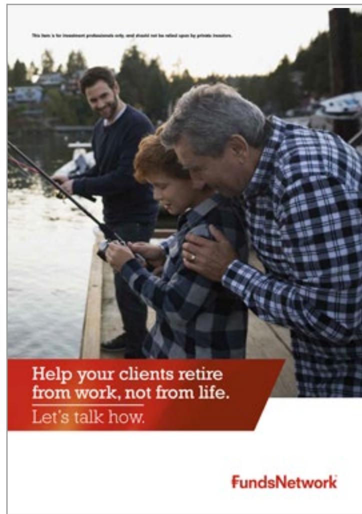
Comparison sites

To help you in your due diligence process, our pension is featured on all the following independent comparison sites:

- AdviserAsset
- Synaptic Comparator
- O&M Systems
- Defaqto Engage
- Selectapension

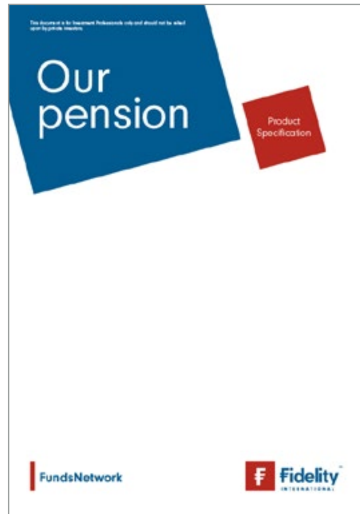
2. Further information available on our website

You can find further information to help with your due diligence in the ['Products and investments'] section of our website, in the Pension section, under 'Helpful documents'.



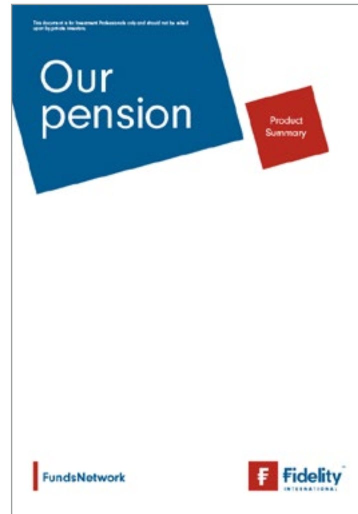
Pension adviser guide

Detailing all the benefits of our flexible pension.



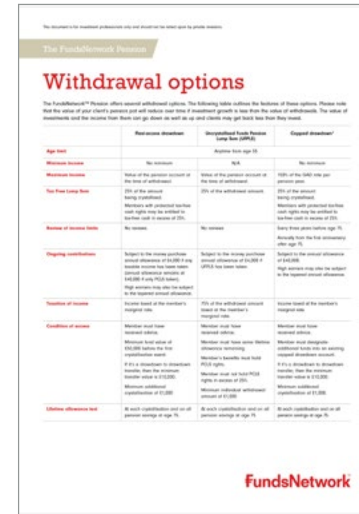
Product specification

Detailed information on the design, features and options available within our pension both pre- and post-retirement.



Product summary

An at-a-glance summary of the key information for our pension.

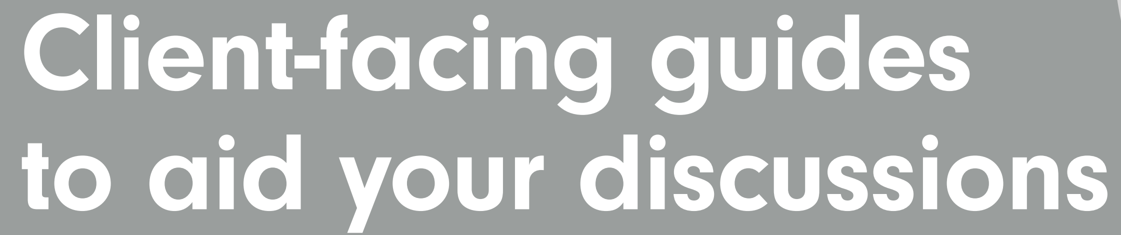


Withdrawal options

A summary of all the features of the various withdrawal options offered by our pension.

Creating your own marketing letters

Suggested wording for your marketing communications.


Client-facing guides
to aid your discussions

A range of client-facing guides, that explain the more complicated aspects of pensions to your clients, in simple terms. They are available on the 'Technical matters' area of our website, under 'Documents to help you with client discussions'.

The tapered annual pension allowance and how it works

How the annual pension allowance can be reduced for certain high-earning individuals.

All you need to know about the pension lifetime allowance

Describes how the government has restricted the tax breaks on pensions through the introduction of the lifetime allowance.

Making pension tax relief work for you

Explains why contributing to a pension is one of the most tax-efficient ways to save for retirement.

Save more into your pension with carry forward

Covers how clients can boost their retirement savings by using unused allowances from previous years.

How does the annual allowance work?

Includes how clients can check their contributions and what happens if the allowance is exceeded.

Making a withdrawal from your pension

Covers what clients should consider when withdrawing money from their pension.

A retirement income you can rely on for life

All clients need to know about annuities and the different types on offer.

Explaining how pension withdrawals are taxed

Covers which pension withdrawals are taxed, how to calculate and deduct tax and how to reclaim if taxed too much.

Other materials that can help you and your firm

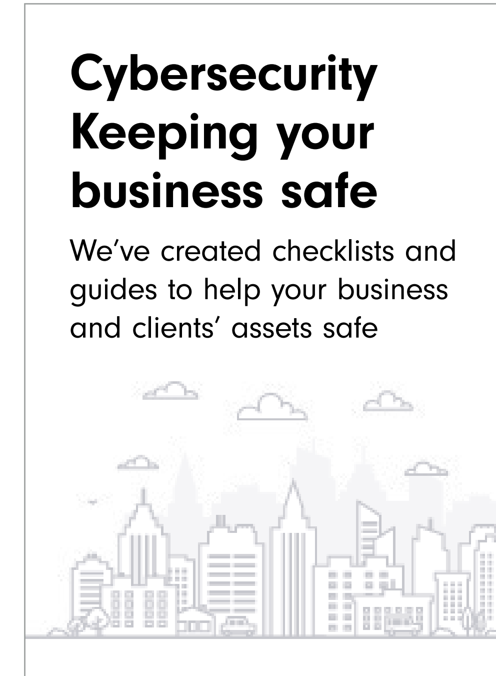
Further insights and resources covering ISAs & Investment Accounts, MiFID II and transactional costs and cyber security are available on our website.

MiFID II:
a closer look at fund transaction costs

What are MiFID II transaction costs?

Why is slippage causing difficulties when reporting costs?

An example of slippage



Recommending our ISA and Investment Account – Supporting you in your due diligence process

All you need to know about the FundsNetwork ISA and Investment Account and why you can recommend them to your clients.

You will find the guide under the section 'Support for your business'.

MiFID II: a closer look at transaction costs

With the increased focus on fund charges – and to help you explain them to your clients – we examine portfolio transaction charges in more detail.

You will find the guide under the section 'Other technical matters'.

Cyber security – keeping your business safe

Materials and videos designed to help you spot and prevent fraudulent activity.

Visit the cybersecurity zone.

Important information

This document is for investment professionals only and should not be relied upon by private investors. The value of investments, and the income from them, can do down as well as up and your clients may get back less than they invest.

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