Pension transfers

AF7: 2017–18 edition

Web update 3: 24 November 2017

Please note the following update to your copy of the **AF7** study text:

Chapter 2, section D2, example 2.2, page 2/16

Replace example 2.2 and the sentence which follows it with the following:

eg

Example 2.2

Julie has accrued 25 years' service in her defined benefit pension scheme. She recently left service and her final pensionable remuneration was £30,000 p.a.

If the defined benefit scheme calculates benefits at retirement on a pension plus cash lump sum scheme basis with an accrual rate of 1/80th, the retirement benefits she accrued to the date of leaving the scheme would be as follows:

- Pension is 25/80ths × £30,000 = £9,375 p.a.; and
- PCLS is 3 × 25/80ths × £30,000 = £28,125.

Alternatively, where the defined benefit scheme calculates benefits at retirement by way of commuting pension to provide PCLS, based on an accrual rate of 1/60th, a commutation factor of 16.2, and the scheme choosing to pay PCLS benefits in line with the maximum permitted under HMRC rules, the benefits would be as follows:

- Where no PCLS is taken, the pension is 25/60ths × £30,000 = £12,500 p.a.
- Alternatively, maximum PCLS is (£12,500 × 16.2)/(1+ (0.15x16.2)) = £59,037.90.
- Plus, a reduced pension of £12,500 – (£59,037.90/16.2) = £8,855.69 p.a.

It is important to note that no element of GMP can be commuted for PCLS, therefore any GMP element might reduce the pension available for commutation.

Chapter 5, revision question and answer 1, pages 5/39–40

Replace question text with the following:

a. Identify, and briefly describe, the benefit crystallisation event that applies where the individual reaches age 75 and still has funds in drawdown.

b. Identify, and briefly describe, the benefit crystallisation event that applies where the individual dies before age 75 and has uncrystallised benefits that are designated for drawdown following the member's death.

When answering both questions, also explain the valuation basis and how the lifetime allowance charge assessment is applied to any excess over the member's remaining lifetime allowance.

Replace the answer text with the following:

a. BCE 5A is the BCE that applies. This is where the original member reaches age 75 with an earlier designated drawdown fund which has not been secured by a lifetime annuity or scheme pension. The valuation basis is the market value of the drawdown fund at age 75 less the market value of the fund designated for drawdown pension at the outset. Any excess over the member's remaining lifetime allowance would be charged at 25%.

b. BCE 5C is the BCE that applies. This is where the original member dies before age 75 and uncrystallised funds remaining at death are designated (before the end of the two-year relevant period following the member's death) to a dependant's or nominee's flexi-access drawdown pension. The valuation basis is the market value of the assets designated as available for drawdown and this is tested against the original member's remaining lifetime allowance. Any excess over the member's remaining lifetime allowance would be charged at 25%.

Appendix 6.1: Case study 1 – At retirement pension transfers, pages 6/33–39

Replace Case study 1, questions and answers with the following:

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)**, **(c)**, **(d)**, **(e)**, **(f)** and **(g)** which follow.

David (age 59) is married to Sandra (age 56). Both are non-smokers and in good health. They have two children, Jasmine and Jason, who are in their early thirties and financially independent. David was made redundant from his job as financial controller at the UK subsidiary of a multinational pharmaceutical company on 31 January 2016. Since then he has been working as a self-employed consultant while he considers his options.

In March 2016, David commenced drawing benefits from his NHS pension scheme. The starting pension was £34,154 p.a., plus a lump sum of £102,462. A certificate issued at the time confirmed that this represented 62.84% of the then lifetime allowance (LTA). Apart from his NHS pension and a defined benefit scheme with his former employer (details below), he has no other pension benefits, and has not had any other benefit crystallisation events (BCEs). David has not applied for any form of transitional protection.

He has provided you with two pages of the CETV statement he recently received from the scheme.

David and Sandra own their main residence outright, having paid off the remainder of their mortgage with part of David's redundancy payment. Sandra is a teacher and is a member of the Teachers' Pension Scheme. She is head of the science department at a local comprehensive school and receives a salary of £52,000 p.a. Her latest statement shows that she has earned a pension of £23,400 p.a., plus a lump sum of £78,000.

They have no life cover in force, have recently updated their wills and have registered lasting powers of attorney. They have advised you that they have substantial other assets outside of their pension schemes, but have provided no further details.

ABC Group Pension Scheme

Guaranteed statement of entitlement of Cash Equivalent Transfer Value (CETV)

Member details			
Member name	David Smith	**Reference number**	0125849
Date of birth	12/05/1958	**National Insurance number**	NHXXXXXXA
Date joined company	20/06/1992	**Date joined scheme**	01/01/1993
Date of leaving	31/01/2016	**Normal retirement date**	12/05/2023

Transfer value - not including additional voluntary contributions (AVCs)	
Total transfer value	£767,760.00
Transfer value includes	
Guaranteed Minimum Pension	£21,570.00
Excess over GMP up to 5 April 1997	£220,466.00
Post 5 April 1997	£525,724.00

The transfer value quoted is guaranteed to xx/xx/xxxx

The calculations are in line with the requirements of the ECJ ruling on the equalisation of pension ages.

Additional voluntary contributions (AVCs)

AVCs are payable in addition to the total transfer value. The AVC fund value cannot be guaranteed and the closing transfer balance will depend on the market values at date of closure. It is important to note that if you invest in AVCs the value of these investments may go down as well as up.

The member has AVCs with Prudential. The current value is £1,440.37

Deferred pension at date of leaving:	
Description	**Scale at date of leaving service**
Post-88 GMP	£938.73 p.a.
Excess accrued to 5 April 1997	£6,698.42 p.a.
Pension accrued 6 April 1997 – 5 April 2006	£9,845.49 p.a.
Pension accrued 6 April 2006 – 5 April 2009	£868.92 p.a.
Pension accrued post 5 April 2009	£7,697.74 p.a.
Total pension	**£26,049.30 p.a.**
Total member scheme contributions	£78,836.54

This pension will be revalued between the date you left pensionable service and the date the benefits are paid - see note on the attached ‘Further information’ sheet for more details.

For details of how this pension will be increased once in payment - see note on the attached ‘Further information’ sheet.

If the Scheme has given or is intending to give discretionary increases, you’ll find information about this under the section called ‘Details of discretionary benefits’.

Transfer in pension

There are no records of any benefits been transferred in to the scheme.

Benefits on death before NRD

If the member dies before NRD, a pension may be paid to the surviving spouse. On the date the member left pensionable service, this pension amounted to:	£13,024.65 p.a.

This pension will be revalued between the date the member left pensionable service and the date of death - see note on the attached ‘Further information’ sheet for more details.

Depending on the rules of the Scheme, other benefits may be payable in addition to the surviving spouse pension shown above. If this is the case, the note on the attached ‘Further information’ sheet will provide more details. This note will also provide details of any circumstances under which the pension payable may be less than that shown above.

Benefits on death after NRD

Please see note on the attached ‘Further information’ sheet for details of the benefits payable under the Scheme should the member die after NRD.

Civil partners

If the member has a civil partner or is married to someone of the same sex their benefits may differ from the figures quoted above - for more information, please see the attached ‘Further information’ sheet. (A civil partnership is where same-sex couples have formally registered as civil partners of each other under the Civil Partnership Act 2004.)

Eligibility for Pension Protection Fund
The ABC Group Pension Scheme is eligible for the Pension Protection Fund (PPF), which aims to help protect members' pensions if a company becomes insolvent, although it doesn't guarantee to pay full benefits. You can find more information about this on the PPF's website at www.pensionprotectionfund.org.uk If you need any more information you can contact us at the address given below. **Important information** We (*Scheme Administration Company*) administer your benefits for the trustees in line with the Scheme's trust deed and rules. We're not authorised by either the trustees or your employer to pay any benefits over and above your entitlement. On a similar note, unless you're specifically told otherwise, we won't be able to change or increase your pension entitlements. We've done all we can to make sure that the figures shown are accurate, but if there are any errors your benefits will be limited to your entitlement. Issued by Scheme Administration Company Limited, ABC Group Pension Scheme, Pensions Admin House, Anytown, TZ10 6RY.

Signed .... Date: xx/xx/xxxx

Questions

To gain maximum marks for calculations you must show all *your workings and express your answers to* two *decimal places*

a. i. Explain how an income and expenditure analysis could help in establishing David and Sandra's retirement needs and objectives. **(7)**

ii. Identify any additional hard and soft facts you would need to establish from David & Sandra in order to advise them as to the suitability of a potential transfer of David's defined benefit scheme with his former employer. **(12)**

b. You have obtained a letter of authority from David addressed to the scheme trustees.

i. Identify the documents you would request from the scheme to help with your research and analysis. **(3)**

ii. In addition to the information contained in the two pages of the CETV statement that David has provided you with, list the information you would also need to have from the scheme administrator in order to complete a TVAS report. **(10)**

c. i. List the statutory revaluation rates that determine the minimum rates of increase that must be applied to the different elements of David's preserved pension. **(4)**

ii. Explain to David how the changes implemented with the introduction in April 2016 of the single-tier State Pension will impact on the annual increases to his defined benefit scheme pension once in payment. **(4)**

d. The scheme funding statement states that an actuarial valuation was completed in May 2016 and the scheme has a solvency rate of 67%. There is a recovery plan in place with the aim of bringing the funding rate to 100% by 2030. The scheme is currently closed and no longer accruing benefits for members.

i. David held a senior position in the business and is aware that the sponsoring employer is facing continuing financial stress. Explain to David what is likely to happen if his previous employer became insolvent. **(4)**

ii. If the scheme were to enter into the PPF assessment period, explain the likely impact this would have on David's pension options. **(4)**

iii. Explain to David how the employer covenant would operate in this scenario. **(5)**

e. David has asked you about the impact of the LTA on his benefits if he were to fully crystallise these now. You have obtained an immediate retirement illustration from the scheme and this confirms that the pension-only option would be £26,309.79 p.a.

i. Calculate, **showing all your workings**, the remaining LTA available to David. **(3)**

ii. Calculate, **showing all your workings**, the pension payable by the scheme, taking into account any LTA charge. Assume that the scheme will pay any LTA charge and the cash commutation rate when doing so is 18.41:1. **(7)**

iii. Calculate, **showing all your workings**, the LTA charge due if David transferred his benefits to a personal pension and immediately crystalized the whole fund. Assume any excess is taken as a lump sum. **(5)**

f. Having completed your analysis you have established that David and Sandra require £4,000 net per month to cover their basic needs. They intend to travel extensively for the first five years and will require additional income of £20,000 net p.a. during this time. Sandra will continue working to her normal retirement age of 60, however, David intends to stop work now and join the local golf club.

Also, their other assets mean that there is likely to be an inheritance tax (IHT) bill in the future when they pass assets to their children. David wants to ensure that his arrangements are as tax-efficient as possible.

i. With this in mind, briefly outline, giving your reasons, a course of action that would address David & Sandra's needs and objectives. **(12)**

Total marks (80)

Answers

a. i. An income and expenditure analysis will help to establish their current standard of living. A detailed analysis will also help to establish the expenditure that is essential and therefore to quantify the minimum level of income required, and additional expenditure to meet their required retirement lifestyle. This can also help to establish how their spending will change pre- andpost-retirement.

It is also useful to assess how realistic their retirement expectations are by matching up what they think they need in retirement with what they are spending. It will also help them identify any potential areas where they would be prepared to compromise. **(7)**

ii. Establish when David wishes to stop work/start requiring pension income, and whether this will be a specific date or phased over a period of time.

Establish Sandra's retirement plans and whether or not these tie in with David's plans. Obtain a detailed summary of all their assets, including ownership, tax status and availability to meet their retirement needs and objectives.

Obtain details of liabilities, including when these are due for payment and the cost of servicing them.

Do they have any plans for retirement? Do they have any hobbies or interests they will take up/expand on in retirement? What are the costs associated with these?

Establish their income needs/capital expenditure requirements in retirement and their likely pattern of expenditure throughout retirement.

Establish how important flexibility is to them with regards to how they draw their pension income.

Establish David's attitude to risk and capacity for loss, and his views as to risk and reward.

Establish how important guarantees are to David.

Establish how important it is for David to maximise the PCLS available when he retires.

Establish David's views as to inflation in the future.

Establish David's view as to the type/flexibility of death benefits he wishes to leave behind for Sandra.

Establish David and Sandra's views as to the importance of being able to pass the pension intact to their children and future descendants.

Establish whether David has a desire to control his pension investments.

Establish David's views as to benefit security / the funding position of the scheme and the financial strength of his former employer.

(12 maximum)

b. i. A full copy of the CETV pack issued, including the 'further information' sheet.

Members' Booklet.

Most recent scheme funding statement. **(3)**

ii. The CETV calculation date.

The scheme status.

Details of the scheme's funding position.

Details as to how PCLS is calculated.

Is a bridging pension included?

Revaluation rates in deferment for all elements of the pension.

Is revaluation applied in whole years or years and months?

Is there any rebate to be received in relation to limited revaluation premium?

Pension increases in payment for each element of the pension.

History and details of any discretionary increases.

Early retirement factors and how/when these are applied.

Earliest age early retirement is available.

Details of the death benefits payable. Are there any lump sum death benefits pre- and post-retirement? Does a guarantee period apply once benefits are in payment?

(10 maximum)

c. i. Post-88 GMP – Fixed rate of 4.75% or s148 orders.

Pre-97 excess – CPI capped at 5%.

Post-April 97 to April 2009 – CPI capped at 5%.

Post-April 2009 benefits – CPI capped at 2.5%. **(4)**

ii. As David will not reach his State Pension age until after the implementation of the single-tier State Pension, the State will no longer pay an annual increase to the GMP element of his DB scheme pension. His Post-88 GMP will therefore increase at CPI capped at 3% p.a., with the increase each year paid by the scheme. Previously,any additional indexation above this level would have been paid through the State Pension. **(4)**

d. i. The PPF will be notified of the insolvency event and, if eligible, the scheme would then enter into an assessment period which would last for a minimum of 12 months. The three possible outcomes of the assessment are that the scheme has sufficient assets to secure member assets, that it can be rescued, or that it would transfer to the PPF. **(5)**

ii. Once in the assessment period transfers are not available and early retirement is only available at the PPF compensation level. This means that David's retirement options and his benefits would be restricted, and the DB scheme cannot pay more than the maximum compensation level amount allowed under the PPF. **(4)**

iii. The covenant is the employer's legal obligation to financially support the scheme. As part of the recovery plan agreed with The Pensions Regulator, the employer must keep an agreed amount aside to cover any scheme deficit. Even where the UK subsidiary is in financial trouble, there is likely to be an additional guarantee provided by the parent company. This would mean that both the UK and the global parent would have to fail for the scheme to be eligible to enter the PPF. **(5)**

e. i. Current LTA £1,000,000.

David used up 62.84% on previous BCE.

Residual LTA remaining: £1,000,000 @ 37.16% = £371,600 **(3)**

ii. Calculate the capital value of the pension: £26,309.79 x 20 = £526,195.80

Deduct the available LTA from the capital value: £526,195.80 - £371,600 = £154,595.80

Apply tax charge of 25% as excess taken as income:

£154,595.80 @ 25% = £38,648.95

Apply the cash commutation rate to calculate the reduction in pension:

£38,648.95/18.41 = £2,099.34

Net Pension after LTA: £26,309.79 - £2,099.34 = £24,210.45 p.a. **(7)**

iii. Deduct the available LTA from the transfer value and AVCs to calculate the excess:

(£767,760 + £1,440.37) - £371,600 = £397,700.37

Apply tax rate of 55% as benefits taken as lump sum:

£397,700.37 @ 55% = £218,735.20

(5)

f. i. David to transfer his benefits to a personal pension, and to apply for both fixed and individual protection 2016.

As Sandra intends to continue working for a further 4 years, her salary together with David's NHS pension will be sufficient to meet their immediate income needs. When Sandra stops work her pension in addition to David's NHS pension will cover their basic income requirement.

They could use their assets outside of the pension scheme to fund their travel plans and thereby reduce their potential IHT liability.

By applying for protection, his lifetime allowance would be increased (if granted) and this would reduce the impact of the LTA. David does not need to crystallise all the benefits from the transferred plan therefore this reduces the potential for an LTA charge.

Transfer to a personal pension will provide David and Sandra with additional flexibility and a tax-free legacy that can be passed to their children on death before age 75. **(12)**

Total marks (80)

Appendix 6.2: Case study 2 – Pre-retirement pension transfers, pages 6/40–43

Replace Case study 2, questions and answers with the following:

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)**, **(c)**, **(d)** and **(e)** which follow.

Dan (age 54) is a pilot and is currently employed by a well-known airline. He is living with his partner Karen (age 36) and they have two young children, Dylan (2) and Edward (4). He is a member of his current employer's defined contribution pension scheme. Dan was previously married. However, his divorce was finalised in 2014. They have no other children from previous relationships. Both Dan and Karen are in good health and non-smokers.

Dan was previously a member of the company's defined benefit pension scheme that has now been closed to all future accrual and is treated as a preserved benefit. He has obtained a CETV in relation to these benefits, an extract of which is shown below:

Personal details	
National Insurance number	JL******C
Date of birth	19 May 1963
Normal retirement date	65
Guaranteed minimum pension age	65
Date pensionable service commenced	01 September 1999
Date of leaving pensionable service	31 March 2011

Transfer entitlement	
Guaranteed transfer value, which includes:	£659,375.45
Plan pension built up before 6 April 1997	
Transfer value of GMP	£0.00
Other rights built up before 6 April 1997	£0.00
Plan pension built up after 5 April 1997	
Contracted-out salary related benefits built up after 5 April 1997	£659,375.45
AVC benefits	£0.00
AVC benefits providing added years	
Non-guaranteed transfer value, which includes:	
Money purchase transfer in	£0.00
Money purchase AVCs	£12,202.42
Guarantee date:	Xx/xx/2017
Pension benefits	Pension as at date of calculation
Plan pension built up after 5 April 1997	£18,595.62 a year
Plan pension built up after 5 April 2009	£3,564.16 a year
Total plan pension	£22,159.78 a year

Dan's salary is £116,478 per annum and he is a deferred member of his employer's DB scheme. In addition to the death benefits payable by his DB scheme, his employer will also pay 3 × salary as a lump sum death benefit through an excepted group life policy while he remains an employee. In addition to the DB pension he also has a defined contribution pension currently valued at £237,167. Employer contributions to the scheme are 18% and Dan's contributions are 10% of salary.

Karen previously worked as an office manager and has some defined contribution benefits. They have a repayment mortgage on their main residence for £250,000 on a property currently valued at £420,000. This is due to be repaid in ten years' time.

Dan does not expect he will be able to afford to retire before age 65. His main concerns are: firstly, providing a guaranteed income in retirement as he wants certainty and is risk adverse; and secondly, he also wants to ensure that Karen and the boys are looked after in the event of his death, especially given the age difference. They have also advised you that they are giving serious consideration to getting married in the near future.

Key points from the member's booklet regarding the DB scheme's death benefits:

If you die before you start to receive your deferred pension, the following benefits are payable:

- **Spouse's pension**

Your **spouse** will receive half of your deferred pension entitlement, including increases to the date of death.

- **Children's allowances**

In addition, each of your children (up to a maximum of 4) will receive an allowance equal to one quarter of the **spouse's** pension.

- **Other dependant's pension**

If you have no **spouse** or children the trustee may, in special circumstances, pay a pension to one or more of your dependants. Any such payment will be at the absolute discretion of the trustee.

- **A lump sum payment**

If no pensions are payable a refund of your contributions to the plan, plus interest, will be paid in the same manner as the life insurance sum described on page 10.

Questions

To gain maximum marks for calculations you **must** *show* **all** *your workings and express your answers to* **two** *decimal places.*

a. Taking into account Dan's circumstances, and wish to ensure that Karen and the boys are looked after in the event of his death, list the additional information you would require from the scheme in order to be able to advise him regarding his DB scheme death benefits. **(10)**

b. You are preparing to complete a transfer value analysis (TVA) for Dan's benefits.

   i. Assuming you have all the relevant personal and scheme information to hand, state the additional information you will need to complete the transfer value analysis (TVA) and explain why it is necessary. **(8)**

   ii. Ignoring the regulatory aspects, explain to Dan how a TVA would be used in assessing the suitability or not of transferring from the scheme. **(12)**

   iii. Briefly explain the limitations of a TVA. **(6)**

c. One of Dan's main objectives is to ensure that Karen and the children are looked after in the event of his death. Based on their current circumstances and the information you already have, explain to Dan the benefits that may be available to them on his death before retirement, assuming he remains with his current employer. In doing so state any potential issues to be aware of, and any limitations or restrictions that may be placed on this. Ignore any tax implications in your answer. **(16)**

d. Explain to Dan the benefits available to Karen in the event of his death if he were to transfer benefits to a personal pension and take benefits by way of flexi-access drawdown. **(8)**

e. i. Outline the main issue that will need to be addressed when advising Dan and Karen with regards to the potential transfer of Dan's DB scheme. **(10)**

   ii. Briefly outline a course of action that may address all of Dan's needs and objectives, stating any potential drawbacks of this approach. **(10)**

Total marks (80)

Answers

a. Establish whether there would be any reduction to the spouse's pension as Karen is more than ten years younger than Dan.

Establish whether the spouse's pension is based on his pre-commutation deferred pension.

Establish the eligibility criteria for the spouse's pension, e.g. is there a minimum period of marriage required?

Establish the eligibility criteria to qualify for the dependant's pension.

Are there any circumstances where the spouse's/dependant's pension would be reduced or cease, such as Karen being significantly younger than Dan, or in the event of her re-marrying or cohabiting?

Establish the eligibility criteria to qualify for the children's allowances.

Establish if the children's allowances will be increased if a spouse's pension is not payable.

Establish the contributions that Dan paid into the DB scheme prior to its closing.

Establish how the rate of interest is ascertained when paying a refund of contributions.

Establish whether Dan has completed a nomination form? If so, what are the details of the nomination?

When the scheme was closed, were there any enhancements to benefits or special terms offered for active members?

Establish whether there Is a pension sharing order or earmarking order in place as a result of his divorce? **(12)**

b. i. Details of the proposed alternative product including all related fees and charges.

Details of the investment proposition including all fees and charges. For discretionary fund manager proposals this should also include the ongoing charges figure (OCF) of the underlying investments in the portfolio.

Details of the initial and ongoing adviser fee for advice.

These details are required by the FCA and ensure that the critical yield is a true reflection of the additional costs that would be incurred on transfer. **(8)**

ii. The TVA provides a comparison of the benefits that would be provided by the scheme and by an alternative plan which could be a stakeholder/ personal pension/ SIPP or a Section 32 plan. The purpose is to illustrate the cost of transferring to an alternative plan in order to achieve the same benefits provided by the existing DB scheme.

The basic analysis and assumptions to be used are set out in legislation to ensure consistency of results, regardless of how the analysis is completed. The analysis compares the benefits provided at the scheme NRD and earlier retirement age if relevant, pension commencement lump sum and death benefits.

The analysis will enable the adviser to demonstrate in monetary terms the cost of giving up the benefits in the scheme. **(10)**

iii. TVA is based on using the funds to buy an annuity to match the scheme benefits.

It is most likely impossible to purchase an annuity that exactly matches the scheme benefits

due to the variations in pension increases in deferment and the different treatment of death benefits.

It doesn't take into account factors like the lifetime allowance or accessing benefits by PCLS/FAD.

A TVA considers the benefits in isolation and not in the context of Dan's overall financial position. **(6)**

c. Dan is entitled to 3 × salary DIS lump sum from the excepted group life policy via a discretionary trust, which is payable at the trustees' discretion. Dan should check that Karen is listed as one of the potential beneficiaries in order that benefits can potentially be paid to her.

In addition to this, the benefits from the defined contribution section would also be available as a lump sum.

Also, subject to a nomination form being completed with Karen as named beneficiary.

The DB scheme provides for a spouse's pension of 50% of the deferred pension revalued to date of death. However, as Dan and Karen are not currently married Karen would not be eligible for this.

The information from the scheme states that a dependant's pension may be payable at the trustees' discretion.

However, no further eligibility criteria were provided. As Karen is clearly financially dependent on Dan and they are living together, it is likely, but not certain, that the trustees would grant Karen a pension.

This is likely to be reduced due to Karen being 18 years younger than Dan. If they were to get married and meet the eligibility criteria, the question of dependency would no longer be an issue.

If no spouse's pension is payable to Karen, then a refund of contributions plus interest would be payable.

Children's allowances would be payable in respect of Dylan and Edward at one-quarter each of the spouse pension payable to the age determined in the scheme rules that they are no longer financially dependent.

This may or may not be enhanced if no spouse's or other dependant's pension is payable.

(16 maximum)

d. In the event of Dan's death before age 75, and assuming his lifetime allowance is not exceeded, then if the death benefits are paid/commence being paid within the two-year relevant period following his death, the full value of the fund would be available to Karen as a tax-free lump sum. Alternatively, the fund could be designated as a dependant's flexi-access drawdown, allowing Karen to make withdrawals of income tax-free as required and potentially leave any residual benefits for Dylan and Edward within the pension wrapper on her death. She could also, if she wishes, purchase a tax-free lifetime annuity with the inherited pension fund, though this could not have any death benefits built-in to it and must end on her death.

If Dan's lifetime allowance is exceeded as a result of the death benefit payable then a lifetime allowance excess charge would be payable at either 25% or 55% depending on whether the excess is taken as income or a lump sum. If any of these three options do not pay out/commence payout within the two-year relevant period following Dan's death then the entire fund will be taxable based on Karen's marginal rate of income tax, but there will be no test against the lifetime allowance. If Dan dies age 75 or over then the same three options would be available to Karen, but any income or lump sum would be taxable at her marginal rate of income tax, and there would be no test against Dan's lifetime allowance. **(8)**

e. i. The main issue that needs to be addressed is that Dan's two main concerns create a conflict.

His need to provide a guaranteed income in retirement is clear and as he wants certainty and is risk adverse, it is unlikely that he would be willing to accept the investment risk associated with an alternative defined contribution plan if he transferred his benefits out of the scheme.

On the other hand, there is no certainty in relation to the benefits that would be payable to Karen in the event of his death. As benefits to dependents are paid at the trustees' discretion it will not be clear until the event, pre- or post-retirement, what benefits would be available to Karen. She could potentially only receive a refund of contributions plus interest plus the children's allowances from the scheme, which would in no way be sufficient to sustain her standard of living. **(10)**

ii. Dan could consider retaining his benefits in the scheme and taking out some life assurance to provide death benefits for Karen and the boys.

This should be a whole of life plan and it will need to be payable on death whenever this occurs, as it is unlikely that Karen's financial dependency will decrease in the future. This would provide certainty in terms of the income payable to Dan in the future and also in terms of the benefits available to Karen in the event of his death. The policy should be written under trust to ensure that benefits are not included in his estate on death, and therefore do not attract IHT.

The problem is that there is likely to be a loading on the premium due to Dan's occupation and this could make it unaffordable. Also, the premiums will have to be maintained throughout his lifetime, and therefore must be affordable in retirement also.

They could also get married, which would mean that Karen was his legal spouse, and so potentially eligible for the spouse's pension. However, eligibility criteria should still be checked with the scheme to ensure she qualifies and how the age difference would affect the spouse's pension. **(10)**

Total marks 80