



Chartered
Insurance
Institute

AF7

Advanced Diploma in Financial Planning

Unit AF7 – Pension transfers

March 2023 Examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2022/2023, unless stated otherwise in the question, and should be answered accordingly.

It should be assumed that all individuals are domiciled and resident in the UK unless otherwise stated.

Unit AF7 – Pension transfers

Instructions to candidates

Read the instructions below before answering any questions

Two hours are allowed for this paper which carries a total of 100 marks as follows:

Section A: 34 marks

Section B: 66 marks

- You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- It is important to show all steps in a calculation, even if you have used a calculator.
- Tax tables are provided at the back of this paper.
- Additional information, relevant to pension planning, is also included at the end of the tax tables on the right-hand side of the interface and back of this paper.

Subject to providing sufficient detail you are advised to be as brief and concise as possible, using note format and short sentences on separate lines wherever possible.

SECTION A

The following questions are compulsory and carry a total of 34 marks

ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX

1. Regarding the Financial Conduct Authority's (FCA) exception to the ban on contingent charging in respect of client's who are in serious financial difficulty:
 - (a) Explain how the FCA defines 'serious financial difficulty'. (5)
 - (b) Outline the **three** examples provided by the FCA that would be deemed unacceptable reasons for relying on the serious financial difficulty exception. (3)

2.
 - (a) Outline the **key** stages in the calculation of a cash equivalent transfer value. (6)
 - (b) State **six** situations where a member of a defined benefit scheme does not have a statutory right to transfer. (6)

3. Olivia, aged 55, has recently received a cash equivalent transfer value (CETV) in respect of her deferred membership of a previous employer's defined benefit pension scheme. The scheme is underfunded but the CETV has not been reduced due to the strength of the sponsoring employer's covenant.
 - (a) Explain what is meant by employer covenant. (4)
 - (b) Explain the significance of the employer covenant in respect of the decision to not reduce the CETV. (3)

4. Sabrina, aged 66, is considering a transfer of her defined benefit pension scheme into a personal pension plan, to commence withdrawals via flexi-access drawdown.
 - (a) Explain to Sabrina what is meant by sequence of returns risk, commonly referred to as sequencing risk. (3)
 - (b) Outline **four** strategies that could be used to reduce its potential impact. (4)

Total marks available for this question: 34

SECTION B

All questions in this section are compulsory and carry an overall total of 66 marks

Case study 1

Read carefully all information provided in the case study before attempting the questions. Your answers should consider the client's circumstances as set out in the case study.

Hana, aged 60, is in a civil partnership with Niki, aged 62. The couple have no children and they both plan to retire on 1 May 2023.

Hana is in excellent health. Niki suffers from high cholesterol and has recently been diagnosed with heart disease. She has been told that if she does not change her lifestyle, her life expectancy may be reduced by up to 10 years.

Both Hana and Niki will receive full State Pensions. The couple's only other pension benefits are held in their respective previous employer's defined benefit pension schemes.

The details of these schemes are:

	Hana	Niki
Normal pension age (NPA)	62	65
Estimated pension at NPA	£38,750 p.a.	£14,500 p.a.
Early retirement factor	From age 60 at 5.2% p.a.	From age 60 at 4.6% p.a.
Commutation rate	12:1	20:1
Escalation rate	RPI capped at 5% p.a.	Statutory minimum
Cash equivalent transfer value	£1,278,750	£500,250
Dependant's pension	66.67%	50%

Neither Hana nor Niki have registered for any form of transitional protection.

Hana and Niki have recently completed a budgeting exercise and estimate their joint income requirements in retirement will be:

- £24,600 net per annum for essential expenditure.
- £10,000 net per annum for lifestyle expenditure.

On first death the income needs of the survivor will reduce by approximately 30%.

The couple's only other assets are a mortgage free main residence, valued at £400,000, emergency cash savings of £10,000, and a jointly held general investment portfolio valued at £52,000.

The couple's objectives are to:

- Ensure they have sufficient income throughout their retirement, with their essential expenditure being met from secure income.
- Explore the option of accepting one of the cash equivalent transfer values with the intention that the withdrawals would cover their discretionary expenditure, until their State Pensions come into payment.
- Ensure their income requirements can be met upon first death.

Hana has a medium attitude to risk (ATR), and Niki has a low ATR.

Questions**ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX**

5. Explain why the couple's objectives in respect of death benefits will be met if the couple transfer Niki's defined benefit pension scheme. (5)
6. Outline the reasons why you would recommend they transfer Niki's scheme as opposed to Hana's. *You should ignore the couple's death benefit requirements when answering this question.* (11)
7. As part of the advice process, you have prepared a cashflow model for Hana and Niki.
- (a) State **five** benefits of cashflow modelling. (5)
- (b) State **five** limitations of cashflow modelling. (5)
8. State the additional information you would require to advise Niki on a suitable investment strategy assuming she transfers her defined benefit pension scheme into a personal pension plan (PPP) to utilise flexi-access drawdown. (7)

Total marks available for this question: 33

Case study 2

Read carefully all information provided in the case study before attempting the questions. Your answers should consider the client's circumstances as set out in the case study.

Surita, aged 56, is married to Juan, aged 64. The couple have been married for five years. Surita has two sons, aged 16 and 18 and Juan has two daughters, aged 32 and 34 all from previous marriages.

Surita was diagnosed with multiple sclerosis 15 years ago and although her illness is not terminal, her life expectancy has been reduced by five to ten years. She had to reduce her working hours three years' ago and Surita has recently been forced to stop work all together on ill-health grounds.

Juan is in good health and is in receipt of a gross scheme pension of £12,500 per annum that includes a 50% spouse's pension. He will be entitled to the full State Pension when he reaches his State Pension age of 66.

The couple live in Surita's house, which is valued at £380,000. There is an outstanding mortgage of £70,000 with a remaining term of nine years. The couple have used up all their savings to cover their household expenses since Surita had to reduce her working hours and are now struggling to pay their household bills. They also have an outstanding credit card liability of £17,500.

Surita can expect a full State Pension when she reaches her State Pension age of 67. She was a member of her employer's defined benefit pension scheme, and has been given permission to take her benefits early on the grounds of ill-health without any early retirement factor being applied. This is Surita's only private pension arrangement.

Surita has recently received a statement of entitlement, which has provided the following information:

Normal pension age (NPA)	65
Scheme pension at date of leaving	£13,200 per annum gross
Revaluation and escalation	Inflation to a maximum of 5% per annum
Spouse's pension (pre- and post-retirement)	50% of member's pension
Children's pensions (pre- and post-retirement)	Payable at trustees' discretion
Pension commencement lump sum (PCLS)	By commutation
Cash equivalent transfer value (CETV)	£369,600

At present the couple need an inflation proofed net income of £3,000 per month to cover their essentials, and a small amount of discretionary expenditure. This will reduce to £2,200 per month if the mortgage and credit card debts are repaid.

Surita would like advice about potentially transferring the benefits from her employer's defined benefit pension scheme to a defined contribution arrangement, to enable her to access her benefits flexibly and repay their debts. Surita is also keen for any residual fund to pass to her children in the event of her death, although she would like Juan to be provided with an income during his lifetime.

Questions

9. State the additional information you would require from the scheme administrator of Surita's employer's defined benefit pension scheme, before making a personal recommendation regarding the potential transfer of her benefits from the scheme. (8)
10. Explain the factors you would consider when advising on the suitability or otherwise, of Surita transferring her employer's defined benefit pension scheme to access the benefits flexibly. *Ensure your answer uses the information provided in the case study.* (15)
11. Surita would like her sons to receive any residual pension fund on second death. However, she would like to ensure that Juan has access to her pension fund if she were to predecease him.
- (a) Explain why you would recommend that Surita's death benefits are nominated to a spousal bypass trust. (5)
- (b) Outline the potential **drawbacks** of this course of action. (5)

Total marks available for this question: 33

INCOME TAX

RATES OF TAX	2021/2022	2022/2023
Starting rate for savings*	0%	0%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Starting-rate limit	£5,000*	£5,000*
Threshold of taxable income above which higher rate applies	£37,700	£37,700
Threshold of taxable income above which additional rate applies	£150,000	£150,000

Child benefit charge:

1% of benefit per £100 of adjusted net income between £50,000 – £60,000

**Only applicable to savings income that falls within the first £5,000 of income in excess of the personal allowance*

Dividend Allowance	£2,000	£2,000
Dividend tax rates		
Basic rate	7.5%	8.75%
Higher rate	32.5%	33.75%
Additional rate	38.1%	39.35%
Trusts		
Standard rate band	£1,000	£1,000
Rate applicable to trusts		
- dividends	38.1%	39.35%
- other income	45%	45%

MAIN PERSONAL ALLOWANCES AND RELIEFS

Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic) §	£12,570	£12,570
Married/civil partners (minimum) at 10% †	£3,530	£3,640
Married/civil partners at 10% †	£9,125	£9,415
Marriage Allowance	£1,260	£1,260
Income limit for Married Couple's Allowance †	£30,400	£31,400
Rent a Room scheme – tax free income allowance	£7,500	£7,500
Blind Person's Allowance	£2,520	£2,600
Enterprise Investment Scheme relief limit on £2,000,000 max**	30%	30%
Seed Enterprise Investment relief limit on £100,000 max	50%	50%
Venture Capital Trust relief limit on £200,000 max	30%	30%

§ the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age (under the income threshold).

† where at least one spouse/civil partner was born before 6 April 1935.

** Investment above £1,000,000 must be in knowledge-intensive companies.

Child Tax Credit (CTC)		
- Child element per child (maximum)	£2,845	£2,935
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£16,480	£17,005

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee

Weekly

Lower Earnings Limit (LEL)	£123
Primary threshold	£242
Upper Earnings Limit (UEL)	£967

Total earnings £ per week

CLASS 1 EMPLOYEE CONTRIBUTIONS

Up to 242.00*	Nil
242.00* – 967.00	12%
Above 967.00	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £123 per week. This £123 to £242* band is a zero-rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. the New State Pension.*

Total earnings £ per week

CLASS 1 EMPLOYER CONTRIBUTIONS

Below 175.00**	Nil
175.00 – 967.00	13.8%
Excess over 967.00	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)

Flat rate per week £3.15 where profits exceed £6,725 per annum.

Class 3 (voluntary)

Flat rate per week £15.85.

Class 4 (self-employed)

9.73% on profits between £11,908 and up to £50,270.

2.73% on profits above £50,270.

PENSIONS

TAX YEAR	LIFETIME ALLOWANCE
2006/2007	£1,500,000
2007/2008	£1,600,000
2008/2009	£1,650,000
2009/2010	£1,750,000
2010/2011	£1,800,000
2011/2012	£1,800,000
2012/2013 & 2013/2014	£1,500,000
2014/2015 & 2015/2016	£1,250,000
2016/2017 & 2017/2018	£1,000,000
2018/2019	£1,030,000
2019/2020	£1,055,000
2020/2021 – 2022/2023	£1,073,100

LIFETIME ALLOWANCE CHARGE

55% of excess over lifetime allowance if taken as a lump sum.

25% of excess over lifetime allowance if taken in the form of income.

ANNUAL ALLOWANCE

TAX YEAR	ANNUAL ALLOWANCE
2014/2015 – 2022/2023	£40,000*

**Reducing by £1 for every £2 of 'adjusted income' over £240,000 to a minimum of £4,000 if 'threshold income' is also over £200,000.*

MONEY PURCHASE ANNUAL ALLOWANCE	2021/2022	2022/2023
	£4,000	£4,000

ANNUAL ALLOWANCE CHARGE

20% – 45% determined by the member's taxable income and the amount of total pension input in excess of the annual allowance or money purchase annual allowance.

CAPITAL GAINS TAX

EXEMPTIONS	2021/2022	2022/2023
Individuals, estates etc	£12,300	£12,300
Trusts generally	£6,150	£6,150
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000

TAX RATES

Individuals:		
Up to basic rate limit	10%	10%
Above basic rate limit	20%	20%
Surcharge for residential property and carried interest	8%	8%
Trustees and Personal Representatives	20%	20%
Business Asset Disposal Relief* – Gains taxed at:	10%	10%
Lifetime limit	£1,000,000	£1,000,000

**For trading businesses and companies (minimum 5% employee or director shareholding) if held for at least two years.*

INHERITANCE TAX

RATES OF TAX ON TRANSFERS

	2021/2022	2022/2023
Transfers made on death		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
Transfers		
- Lifetime transfers to and from certain trusts	20%	20%

A lower rate of 36% applies where at least 10% of deceased's net estate is left to a registered charity.

MAIN EXEMPTION

Transfers to		
- UK-domiciled spouse/civil partner	No limit	No limit
- non-UK-domiciled spouse/civil partner (from UK-domiciled spouse)	£325,000	£325,000
- main residence nil rate band*	£175,000	£175,000
- UK-registered charities	No limit	No limit

**Available for estates up to £2,000,000 and then tapered at the rate of £1 for every £2 in excess until fully extinguished.*

Lifetime transfers		
- Annual exemption per donor	£3,000	£3,000
- Small gifts exemption	£250	£250
Wedding/civil partnership gifts by		
- parent	£5,000	£5,000
- grandparent/bride and/or groom	£2,500	£2,500
- other person	£1,000	£1,000

100% relief: businesses, unlisted/AIM companies, certain farmland/building

50% relief: certain other business assets

Reduced tax charge on gifts within 7 years of death:

- Years before death	0-3	3-4	4-5	5-6	6-7
- Inheritance Tax payable	100%	80%	60%	40%	20%
Quick succession relief:					
- Years since IHT paid	0-1	1-2	2-3	3-4	4-5
- Inheritance Tax relief	100%	80%	60%	40%	20%

PRIVATE VEHICLES USED FOR WORK

	2021/2022 Rates	2022/2023 Rates
Cars		
On the first 10,000 business miles in tax year	45p per mile	45p per mile
Each business mile above 10,000 business miles	25p per mile	25p per mile
Motorcycles	24p per mile	24p per mile
Bicycles	20p per mile	20p per mile

MAIN CAPITAL AND OTHER ALLOWANCES

	2021/2022	2022/2023
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£1,000,000	£1,000,000
Plant & machinery* first year allowance for companies to 31/3/2023: Super-deduction		130%
Special rate		50%
Plant & machinery (reducing balance) per annum	18%	18%
Patent rights & know-how (reducing balance) per annum	25%	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum	6%	6%
Energy & water-efficient equipment	100%	100%
Zero emission goods vehicles (new)	100%	100%
Electric charging points	100%	100%
Qualifying flat conversions, business premises & renovations	100%	100%
Motor cars: Expenditure on or after 1 April 2016 (Corporation Tax) or 6 April 2016 (Income Tax)		
CO ₂ emissions of g/km:	0*	1-50
		Over 50
Capital allowance:	100%	18%
	first year	reducing balance
		reducing balance

**If new and unused*

MAIN SOCIAL SECURITY BENEFITS

		2021/2022	2022/2023
		£	£
Child Benefit	First child	21.15	21.80
	Subsequent children	14.00	14.45
	Guardian's allowance	18.00	18.55
Employment and Support Allowance	Assessment Phase		
	Age 16 - 24	Up to 59.20	Up to £61.05
	Aged 25 or over	Up to 74.70	Up to £77.00
	Main Phase		
	Work Related Activity Group	Up to 104.40	Up to 107.60
	Support Group	Up to 114.10	Up to 117.60
Attendance Allowance	Lower rate	60.00	61.85
	Higher rate	89.60	92.40
Basic State Pension	Single	137.60	141.85
	Married	275.20	283.70
New State Pension	Single	179.60	185.15
Pension Credit	Single person standard minimum guarantee	177.10	182.60
	Married couple standard minimum guarantee	270.30	278.70
	Maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Support Payment	Higher rate – First payment	3,500.00	3,500.00
	Higher rate – monthly payment	350.00	350.00
	Lower rate – First payment	2,500.00	2,500.00
	Lower rate – monthly payment	100.00	100.00
Jobseeker's Allowance	Age 18 - 24	59.20	61.05
	Age 25 or over	74.70	77.00
Statutory Maternity, Paternity and Adoption Pay		151.97	156.66

CORPORATION TAX

	2021/2022	2022/2023
Standard rate	19%	19%

VALUE ADDED TAX

	2021/2022	2022/2023
Standard rate	20%	20%
Annual registration threshold	£85,000	£85,000
Deregistration threshold	£83,000	£83,000

STAMP DUTY LAND TAX

	Residential
Value up to £250,000	0%
£250,001 - £925,000	5%
£925,001 - £1,500,000	10%
£1,500,001 and over	12%

Additional Stamp Duty Land Tax (SDLT) rules apply as below:

- *First-time buyers benefit from SDLT relief on purchases up to £625,000 when purchasing their main residence. On purchases up to £425,000, no SDLT is payable. On purchases between £425,000 and £625,000, a flat rate of 5% is charged on the balance above £425,000.*
- *Additional SDLT of 3% may apply to the purchase of additional residential properties purchased for £40,000 or greater.*
- *SDLT may be charged at 15% on interests in residential dwellings costing more than £500,000 purchased by certain corporate bodies or non-natural persons.*
- *SDLT is payable in England and Northern Ireland only. Land Transaction Tax (LTT) is payable in Wales and Land and Buildings Transaction Tax (LBTT) is payable in Scotland. The rates for LTT and LBTT are different to the rates shown above.*

	Non residential
Value up to £150,000	0%
£150,001 and £250,000	2%
£250,001 and over	5%

SUPPLEMENTARY INFORMATION PENSION PAPERS – AF7 2022/2023

REVALUATION

Guaranteed Minimum Pension – Fixed rate

Date of leaving service	Fixed rate of revaluation
Before 6 April 1988	8.5%
Between 6 April 1988 and 5 April 1993	7.5%
Between 6 April 1993 and 5 April 1997	7.0%
Between 6 April 1997 and 5 April 2002	6.25%
Between 6 April 2002 and 5 April 2007	4.5%
Between 6 April 2007 and 5 April 2012	4.0%
Between 6 April 2012 and 5 April 2017	4.75%
Between 6 April 2017 and 5 April 2022	3.5%
After 5 April 2022	3.25%

Non GMP benefits – statutory minimum rates

Date of leaving service	Statutory rate of revaluation
Before 1 January 1986	No requirement to revalue benefits
Between 1 January 1986 and 31 December 1990	CPI capped at 5% in respect of non GMP benefits accrued from 1 January 1985
Between 1 January 1991 and 5 April 2009	CPI capped at 5% in respect of all non GMP benefits
After 5 April 2009	CPI capped at 5% in respect of all non GMP benefits accrued before 6 April 2009 CPI capped at 2.5% in respect of all benefits accrued after 5 April 2009

NOTE: Statutory revaluation is based on RPI for revaluation prior to 2011

ESCALATION

Statutory rates of escalation: Member reached State Pension age before 6 April 2016

Accrual	Statutory rate of escalation
GMP: Accrual prior to 6 April 1988	Scheme: No requirement to provide any increases in payment State: Fully in line with CPI
GMP: Accrual between 6 April 1988 and 5 April 1997	Scheme: CPI capped at 3% State: Any increases in CPI in excess of 3%
Non GMP: Accrual prior to 6 April 1997	Scheme: No requirement to increase in payment
Non GMP: Accrual between 6 April 1997 and 5 April 2005	Scheme: CPI capped at 5% (LPI)
Non GMP: Accrual from 6 April 2005	Scheme: CPI capped at 2.5%

NOTE: Statutory escalation was based on RPI prior to 2011

Statutory rates of escalation: Member reaches State Pension age on or after 6 April 2016

Accrual	Statutory rate of escalation
GMP: Accrual prior to 6 April 1988	Scheme: No requirement to provide any increases in payment
GMP: Accrual between 6 April 1988 and 5 April 1997	Scheme: CPI capped at 3%
Non GMP: Accrual prior to 6 April 1997	Scheme: No requirement to increase in payment
Non GMP: Accrual between 6 April 1997 and 5 April 2005	Scheme: CPI capped at 5% (LPI)
Non GMP: Accrual from 6 April 2005	Scheme: CPI capped at 2.5%

NOTE: No increase to GMP is made by the State (via the State Pension) for individuals who reach State Pension age on or after 6 April 2016

PENSION PROTECTION FUND

Compensation cap no longer applies following a Court of Appeal ruling in July 2021 that it was unlawful on the grounds of age discrimination.

Revaluation of deferred benefits within PPF

Service	Rate of revaluation
All service before 6 April 2009	CPI capped at 5%
All service after 5 April 2009	CPI capped at 2.5%

Escalation of benefits in payment from PPF

Service	Rate of revaluation
All service before 6 April 1997	No increases
All service after 5 April 1997	CPI capped at 2.5%