Chartered Insurance Institute

AF7

Advanced Diploma in Financial Planning

Unit AF7 – Pension transfers

September 2023 Examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2023/2024, 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: 31 marks
Section B: 69 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 supplementary 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 31 marks

ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX

1. An authorised financial adviser is providing full pension transfer advice to a client that is subject to the ban on contingent charging. They are about to issue a personalised charges communication as set out by the Financial Conduct Authority in the Conduct of Business Sourcebook 6.1A.

Outline the required content of the personalised charges communication. **(8)**

2. Tina, aged 57, is single. She was a member of a former employer's defined benefit pension scheme between 1985 and 2001. Tina has received a statement of entitlement that shows part of the scheme benefits are made up of a guaranteed minimum pension (GMP).

Outline the information you would consider, **in respect of the GMP benefits**, when evaluating a potential transfer of the cash equivalent value to a personal pension plan. **(10)**

3. State the information scheme trustees must provide to a deferred scheme member who has requested a cash equivalent transfer value. **(5)**

4. Babatunde, aged 55, has recently received a cash equivalent transfer value (CETV) in respect of his previous employer's defined benefit pension scheme. This is the third CETV he has received in the past three years and Babatunde is keen to understand why the value keeps changing.

Explain, in detail, the impact on the CETV following an **increase** in the:

(a) inflation assumption; **(4)**

(b) gilt yield. **(4)**

Total marks available for this question: 31

SECTION B

All questions in this section are compulsory and carry an overall total of 69 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.

Petra, aged 55, is married to Lars, aged 57 and they are both in good health. Although they have no children of their own, the couple have fostered a number of children over the last ten years and are currently fostering two siblings aged 5 and 8 on what is expected to be a short-term placement of up to two years. They intend to take a break from fostering once this current placement ends so they can start to travel in the early years of their retirement.

Petra is a solicitor and earns £87,000 per annum. She is a member of her employer's Group Personal Pension plan (GPP) into which she contributes 10% of her salary, which her employer matches. Her GPP is currently worth £735,000.

Lars gave up his employment when they became foster parents. He currently receives a foster allowance of £350 per week. Lars has preserved benefits in his previous employer's contracted-in defined benefit pension scheme but has no other private pension provision. He has been provided with a cash equivalent transfer value (CETV) of £245,600.

Lars' benefits in the defined benefit pension scheme are summarised as follows:

Normal pension age (NPA)	60
Pension at NPA	£12,300 per annum
Death benefits pre-retirement	Return of contributions with interest only Currently valued at £23,000
Death benefits post-retirement	5-year guarantee period and 2/3rds spouse's pension
Escalation	Fixed 5%
Revaluation	Fixed 5%

Petra would like to phase her retirement and the couple will need to subsidise their income until Petra fully retires when Lars reaches age 60.

The couple's home is valued at £450,000 and has an outstanding mortgage of £32,800. They have an emergency fund of £40,000 held in joint names and an investment portfolio valued at £270,000. The investment portfolio is made up of identical stocks and shares ISAs, invested in cautious managed funds which are appropriate for their attitude to risk.

The couple's objectives are:

- To have fully repaid their mortgage.
- Maintain their current net income whilst Petra phases her retirement.
- To have a net joint income of £50,000 per annum in retirement, reducing to a minimum of £30,000 upon first death.
- To maximise the use of personal allowances in retirement.

Questions

ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX

5. State the additional information you would require in respect of Petra and Lars's personal and financial circumstances before advising on the suitability or otherwise of Lars transferring the value of his defined benefit pension scheme into an individual arrangement. **(10)**

6. Based on the information in the case study, outline the factors that support a recommendation that Lars does not transfer the value of his defined benefit pension scheme. **(10)**

7. As part of the transfer advice process, a cash flow forecast has been prepared for Petra and Lars.

(a) Explain the main purpose of a cash flow forecast, including its relative benefits, as part of the advice process. **(7)**

(b) State **five** stress tests that should be included as part of a cash flow forecast. **(5)**

Total marks available for this question: 32

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.

Angus, aged 63 is married to Kay, aged 59. Angus is in full time employment and Kay has spent the last 15 years in unpaid voluntary work for a local charity. The couple, who have no children, plan to retire when Kay reaches the age of 60 in January 2024.

Their main residence is valued at £380,000 and is mortgage free. Having been on several lavish holidays in recent years the couple have credit card debts of £28,000 which they are keen to pay off.

Angus and Kay are in good health and they both have a history of longevity in their families.

Both Angus and Kay have deferred benefits in previous employers' defined benefit pension schemes, summarised as follows:

	Angus	**Kay**
Date of joining scheme	January 1989	September 1990
Date of leaving scheme	August 2013	June 2005
Normal pension age (NPA)	65	60
Scheme pension at NPA	£19,750 per annum gross	£7,250 per annum gross
Early retirement	From age 55 with an actuarial reduction of 4% per annum	From age 55 with an actuarial reduction of 6% per annum
Spouses'/civil partner pension	67% in deferment and retirement	50% in deferment and retirement
Increases to pension in payment	Retail Prices Index capped at 5% per annum	Statutory minimum
Cash equivalent transfer value (CETV)	£511,000	£174,000

In addition to their defined benefit pension schemes, Angus has a workplace Group Personal Pension plan valued at £18,500 but Kay has no other private pension provisions.

The couple have received State Pension forecasts that show that Angus will receive a full State Pension when he reaches his State Pension age of 66 and Kay will receive a State Pension of £9,700 when she reaches her State Pension age of 67.

Angus and Kay estimate that they will require a joint net inflation proofed income of £2,000 per month to cover their essential and discretionary income needs in retirement; of which their essential income needs total £1,200 per month. In the event of the death of one of them their net essential and discretionary income needs will fall to £1,500 per month. They would also like to clear their debts and estimate that they will need an additional net capital sum of around £5,000 per annum to cover the cost of ad-hoc spending such as holidays.

Angus and Kay have requested advice on whether a transfer of the benefits held in one of their defined benefit pension schemes to a personal pension plan, would help to meet their objectives now and in retirement. They both have recently been assessed as having a cautious attitude to investment risk.

Questions

ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX

8. You have recommended that Kay transfers the benefits from her defined benefit pension scheme into a personal pension plan (PPP) and, that Angus takes the benefits from his defined benefit pension scheme when he reaches the scheme's normal pension age of 65.

Explain, based on the information provided in the case study, why you have recommended that Kay's pension is the one that should be transferred rather than Angus's. **(12)**

9. As part of your analysis, you are considering using some of the transferred PPP fund to purchase a lifetime annuity to cover any shortfall in the couple's essential expenditure. The best available joint life index linked annuity rate is 3.8%.

Explain, based on the information provided in the case study, the factors you would consider in deciding whether this course of action should be recommended. **(10)**

10. You have decided to recommend that Kay crystallises enough of her PPP fund to realise a pension commencement lump sum to repay the couple's debts. The balance of the fund will then be invested into a flexi-access drawdown (FAD) fund, which will be used to meet the couple's immediate income and capital requirements.

Outline the potential death benefits that would be payable to Angus in respect of the FAD in the event of Kay's death, including their Income Tax treatment. **(8)**

11. Kay is not entitled to the full State Pension, but she can, if she wishes, make Class 3 National Insurance Contributions (NICs) to top up her State Pension.

Explain why you have recommended that Kay should pay Class 3 NICs. **(7)**

Total marks available for this question: 37

INCOME TAX

RATES OF TAX	2022/2023	2023/2024
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	£125,140

High income 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.*

	2022/2023	2023/2024
Personal savings allowance (for savings income):		
Basic rate taxpayers	£1,000	£1,000
Higher rate taxpayers	£500	£500
Additional rate taxpayers	Nil	Nil
Dividend Allowance	£2,000	£1,000
Dividend tax rates		
Basic rate	8.75%	8.75%
Higher rate	33.75%	33.75%
Additional rate	39.35%	39.35%
Trusts		
Standard rate band	£1,000	£1,000
Rate applicable to trusts		
- dividends	39.35%	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% *†*	£3,640	£4,010
Married/civil partners at 10% *†*	£9,415	£10,375
Marriage Allowance	£1,260	£1,260
Income limit for Married Couple's Allowance*†*	£31,400	£34,600
Rent a Room scheme – tax free income allowance	£7,500	£7,500
Blind Person's Allowance	£2,600	£2,870
Enterprise Investment Scheme relief limit on £2,000,000 max**	30%	30%
Seed Enterprise Investment relief limit on £200,000 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.*

	2022/2023	2023/2024
Child Tax Credit (CTC)		
- Child element per child (maximum)	£2,935	£3,235
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£17,005	£18,725

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
Over £175.00	13.8%

*** Secondary threshold.*

CLASS 2 (self-employed)	
Flat rate per week	£3.45
Small profits threshold per year	£6,725
Lower profits limit per year	£12,570

Class 3 (voluntary)	Flat rate per week £17.45.
Class 4 (self-employed)	9% on profits between £12,570 and up to £50,270. 2% 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 – 2023/2024*	£1,073,100

**Lifetime allowance charge removed after 5 April 2023. Any excess over the lifetime allowance that would have been subject to a lifetime allowance charge of 55% prior to 2023/2024 will be taxable as the member's pension income via PAYE.*

Maximum tax-free pension commencement lump sum in 2023/2024 is £268,275 unless a higher amount is protected.

ANNUAL ALLOWANCE

TAX YEAR	ANNUAL ALLOWANCE
2014/2015 – 2022/2023	£40,000*
2023/2024	£60,000**

**From 6 April 2016 the annual allowance is reduced for those with income above a certain level. Between 2020/21 and 2022/23 the annual allowance will be reduced 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.*

***Reducing by £1 for every £2 of 'adjusted income' over £260,000 to a minimum of £10,000 if 'threshold income'is also over £200,000.*

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.

MONEY PURCHASE ANNUAL ALLOWANCE	2022/2023	2023/2024
	£4,000	£10,000

CAPITAL GAINS TAX

ANNUAL EXEMPTIONS	2022/2023	2023/2024
Individuals, estates etc	£12,300	£6,000
Trusts generally	£6,150	£3,000
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:		
Residential property	28%	28%
Other chargeable assets	20%	20%
Business Asset Disposal Relief*	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	2022/2023	2023/2024
Transfers made on death		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
- Reduced rate (where appropriate charitable contributions are made)	36%	36%
Transfers		
- Lifetime transfers to and from certain trusts	20%	20%

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
- Annual small gifts exemption per donor	£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%

MAIN SOCIAL SECURITY BENEFITS

		2022/2023	2023/2024
		£	£
Child Benefit	First child	21.80	24.00
	Subsequent children	14.45	15.90
	Guardian's allowance	18.55	20.40
Employment and Support Allowance	Assessment Phase		
	Age 16 - 24	Up to 61.05	Up to 67.20
	Aged 25 or over	Up to 77.00	Up to 84.80
	Main Phase		
	Work Related Activity Group	Up to 107.60	Up to 84.80*
	Support Group	Up to 117.60	Up to 129.50
Attendance Allowance	Lower rate	61.85	68.10
	Higher rate	92.40	101.75
Basic State Pension	Category A full rate	141.85	156.20
	Category B full rate	85.00	93.60
New State Pension	Full rate	185.15	203.85
Pension Credit	Standard minimumguarantee - single	182.60	201.05
	Standard minimum guarantee - couple	278.70	306.85
	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	61.05	67.20
	Age 25 or over	77.00	84.80
Statutory Maternity, Paternity and Adoption Pay		156.66	172.48

**If a claim has begun before 3rd April 2017 the individual will also be awarded the Work Related Activity Component payment which in 2023/2024 is £33.70, so total awarded for these individuals may be up to £118.50.*

CORPORATION TAX

	2022/2023	2023/2024
Small profit rate - for taxable profits below £50,000	N/A	19%
Marginal rate – for taxable profits between £50,001 - £250,000	N/A	26.5%
Standard rate - for taxable profits above £250,000	19%	25%

VALUE ADDED TAX

	2022/2023	2023/2024
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 follows:

- *First-time buyers benefit from SDLT relief on first £425,000 for properties up to £625,000 when purchasing their mainresidence. On purchases up to £425,000, no SDLT is payable. On purchases between £425,001 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. Therates 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 2023/2024

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.

PPF Compensation:	
Members who have already reached the scheme's normal pension age when the employer suffers an insolvency event	100%
Members who have not reached the scheme's normal pension age when the employer suffers an insolvency event	90%

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%