

CISI
CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

Investment Advice Diploma

Financial Planning & Advice

Edition 9 July 2025

CISI APPROVED WORKBOOK

20089900696
Printed on Carbon Captured paper

This learning workbook relates to syllabus version 9.0 and will cover exams from 1 October 2025 to 30 September 2026

Welcome to the Chartered Institute for Securities & Investment's Financial Planning and Advice study material.

This workbook has been written to prepare you for the Chartered Institute for Securities & Investment's Financial Planning and Advice examination.

Published by:
Chartered Institute for Securities & Investment
© Chartered Institute for Securities & Investment 2025
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It is estimated that this workbook will require approximately 140 hours of study time.

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Billy Snowdon, Team Leader, Brewin Dolphin

Chapter One

Financial Planning

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This syllabus area will provide approximately 17 of the 80 examination questions



1. Financial Planning Fundamentals

1.1 Financial Planning Fundamentals

Learning Objective

1.1.1 Understand the key purposes of financial planning and who is involved in the process

1.1.2 Know the six-step financial planning process as defined by the Financial Planning Standards Board (FPSB): establish and define the client-planner relationship; collect client data, including personal and financial objectives, needs and priorities; analyse and evaluate the client's financial status; develop and present a financial plan and recommendations; implement the financial planning recommendations; review the client's situation; agree on responsibilities and terms for review of the client's situation; review and re-evaluate the client's situation

1.1.3 Be able to analyse the key components of a financial plan to include: client objectives, needs, wants and values; client attitudes to risk; financial planning assumptions; analysis of a client's current financial situation; financial planning strategy; financial planning action plan and recommendations; review financial plan and recommendations; review strategy

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Financial planning, by its nature, forces individuals to forward plan. The benefit of this is that not only can they start actively creating the sort of future they envisage, but they can also have contingencies in place when unexpected events occur.

Financial planning is key in helping clients with:

- financial understanding
- managing budgets
- creating emergency funds
- protecting income in the event of illness
- protecting **dependants** in the event of death
- choosing investments to suit a risk profile and objectives
- planning for a comfortable retirement, and
- reducing tax **liabilities**.

Financial planning is a cyclical process and so it constantly evolves during someone's lifetime as their circumstances change.

The process is made up of the following six steps:

1. Establish and define the relationship with the client.
2. Collect relevant client information including goals, objectives and priorities.
3. Analyse the client's financial situation.
4. Develop financial planning recommendations and present them to the client.
5. Implement the recommendations.
6. Review progress and modify as necessary.

Financial planning and financial advice can often be used to describe the same thing, yet they do have different meanings. Financial planning is a process that evolves over time, whereas financial advice is a recommendation at a fixed point in time. It will often involve giving investment advice as regulated under the Financial Services and Markets Act (FSMA) 2000, but this is not always the case. It is possible to produce a financial plan which does not involve the use of financial products and will not necessarily involve recommending a product. In some cases, a client's affairs just need rearranging. Financial planning recognises the consequences or knock-on effects that one action can have on circumstances or objectives. Financial planning can, therefore, be thought of as a comprehensive process, culminating in the creation of a financial plan covering all aspects of a client's financial needs. Financial advice is different in that it may be restricted to one or two areas, such as protection or retirement planning.

You should note that the terms 'financial planner' and 'financial adviser' are also often interchangeable; however, as we are considering financial planning to cover all financial needs, we will use the term 'financial planner'.

A financial planner will often work with a paraplanner. Their role is to support the financial planner and they will often take on a number of the non-client facing tasks involved with preparing a financial plan. This could include analysing a client's situation, carrying out research into products or providers, or even drafting the financial plan itself.

However, the financial planner is ultimately responsible for the client relationship and the delivery of the financial plan, even if a paraplanner has carried out many of the tasks on their behalf.

1.1.1 The Six-Step Financial Planning Process

A financial plan may be very simple or very complex; however, the production of a plan will always result from following the financial planning process. Financial planning is both a cyclical and dynamic process. The Financial Planning Standards Board (FPSB) process includes at least six steps, which form an ongoing cycle:



The steps in the financial planning process are as follows:

1. **Establish and define the client-planner relationship** – the financial planning professional informs the client about the financial planning process, the services that they offer and their competencies and experience. The financial planning professional and the client determine whether the services offered and their competencies meet the needs of the client. The financial planning professional considers their skills, knowledge and experience in providing the services requested or likely to be required by the client. The financial planning professional determines whether they have any conflicts of interest and, if they have, discloses them. The financial planning professional and the client agree on the services to be provided. The financial planning professional describes, in writing, the scope of the engagement before any financial planning is provided, including details about: the responsibilities of each party (including third parties); the terms of the engagement; and compensation and conflict(s) of interest of the financial planning professional.
   The scope of the engagement is set out in writing in a formal document signed by both parties and formally accepted by the client. It includes a process for terminating the engagement.
2. **Collect client data, including personal and financial objectives, needs and priorities** – the financial planning professional and the client identify the client's personal and financial objectives, needs and priorities that are relevant to the scope of the engagement before making and/or implementing any recommendations. The financial planning professional collects sufficient quantitative and qualitative information and documents about the client relevant to the scope of the engagement before making and/or implementing any recommendations.

3. **Analyse and evaluate the client's financial status** – the financial planning professional analyses the client's information, subject to the scope of the engagement, to gain an understanding of the client's financial situation. They assess the strengths and weaknesses of the client's current financial situation and compare them to the client's objectives, needs and priorities.
4. **Develop and present a financial plan and recommendations** – the financial planning professional considers one or more strategies relevant to the client's current situation that could reasonably meet the client's objectives, needs and priorities; develops the financial planning recommendations based on the selected strategies to reasonably meet the client's confirmed objectives, needs and priorities; and presents the financial planning recommendations and the supporting rationale in a way that allows the client to make an informed decision.
5. **Implement the financial planning recommendations** – the financial planning professional and the client agree on implementation responsibilities that are consistent with the scope of the engagement, the client's acceptance of the financial planning recommendations including costs payable, and the financial planning professional's ability to implement the financial planning recommendations. Based on the scope of the engagement, the financial planning professional identifies and presents appropriate product(s) and service(s) that are consistent with the financial planning recommendations accepted by the client.
6. **Review the client's situation** – the financial planning professional and the client mutually define and agree on terms for reviewing and re-evaluating the client's situation, including goals, risk profile, lifestyle and other relevant changes. If conducting a review, the financial planning professional and the client review the client's situation to assess progress toward achievement of the objectives of the financial planning recommendations, determine if the recommendations are still appropriate, and confirm any revisions mutually considered necessary.

As the financial planning process is cyclical, the plan itself constantly evolves. Assets and liabilities change as time passes, as does income and the cost of living, often by differing rates or amounts. To counter these issues, the financial plan includes regular reviews.

At review, the client and the financial planner will revisit the client's objectives and goals to see whether they are being achieved and remain relevant. Assumptions and other factors included in the financial plan are also reviewed and amended if necessary.

The financial plan and the recommendations which have been provided to the client will also need to be reviewed to confirm that they continue to meet the client's objectives and goals or whether revision may be necessary.

This is more likely to be the case if circumstances, objectives and/or goals have changed significantly. However, it may also be that products are not performing as well as hoped and goals may need to be revised due to external factors, such as delaying retirement age.

The planner and the client should agree at the outset how often the client's financial plan should be reviewed and what areas the review should focus on.

As well as the financial plan itself, you might need to provide the client with:

- a client agreement
- a suitability report
- product information

- the aggregated costs of the financial plan, including the costs of advice and recommended products
- key features/key information/key investor information documents, and
- illustrations.

However, it should be recognised that items such as product illustrations, key documents and suitability reports may only be required if certain, specific product recommendations are being made and implemented. As a minimum, a planner needs to provide a written summary confirming why the recommendations made continue to be suitable, or if revisions are made, the reasons why the original strategy is no longer suitable.

As mentioned, financial planning does not need to involve the use of financial products or to be a regulated process, although many financial planning practices may still require that regulatory processes are followed.

Although the financial planner has the ultimate responsibility for managing the six-step process, the paraplanner is often also heavily involved. Some financial planners prefer that their paraplanners attend all client meetings and, in some financial planning practices, the paraplanner may be the first point of contact for clients' day-to-day queries.

As in any successful professional relationship, the trust between client and financial planner is fundamental, especially as we have identified the importance of the relationship being long term to take into account any changes in the client's personal circumstances. Client trust is covered in further detail in section 5.2.

1.1.2 The Key Components of a Financial Plan

The financial plan should be prepared and presented in a way that can be easily understood by the client. The overuse of industry or technical jargon should be avoided while ensuring that the financial plan retains its technical accuracy. Similarly, everyday colloquialisms should be avoided as the financial plan is a professional document.

The financial plan should:

- State the current position of the client – in other words, where they are today financially.
- Evaluate the current financial position, including assets and liabilities, income and expenditure.
- State what the client's goals and objectives are: these can be broken down into short, medium and long term.
- Demonstrate any shortfall between the client's objectives and any existing provision they have in place.
- Recommend solutions to make up the shortfall and achieve stated objectives.
- Highlight any disadvantages of the plan, such as increased costs, and any additional risks.

If, as often happens, a client cannot afford to satisfy all the objectives at this stage, they would need to be prioritised. After agreement with the client, the financial plan is then implemented, with a clear summary of what has been put in place, including details of any products and funds that might have been set up.

The financial plan is an evolving document, as are the client's circumstances, and if the client's goals and objectives change, the financial plan must be updated accordingly. All plans should be reviewed regularly to make sure they are still relevant, are still on track to meet the client's objectives, and reflect any changes in circumstances. There may also be goals that had been identified initially, but could not be dealt with at the time, and can now be addressed. Reviews should take place at least once a year, but this may be more often if the client requests it or if circumstances change quickly, for example as a result of redundancy, death or receiving an inheritance.

At the review stage, any planning assumptions that were made when the plan was prepared should also be reconsidered to check that they are still realistic and relevant. This is often one of the tasks that a paraplanner will carry out, as well as ensuring client information is up to date.

The financial plan will generally cover the following areas:

- **Client objectives and priorities** – a statement of the client's objectives listed in order of importance.
- **Financial planning assumptions** – a statement of the assumptions that have been used to create the financial plan, for example, the rate of **inflation**, the rates of return available on different asset classes, and life expectancy.
- **Attitude to risk** – this includes an explanation of what risk is, as well as the client's attitude to risk.
- **Capacity for loss** – how much can the client afford to lose if investments do not perform as expected.
- **Net worth** – a statement of the client's assets and liabilities.
- **Income and expenditure** – a statement of the client's income and expenditure, taking into account income tax and National Insurance (if applicable) to arrive at a net spendable surplus or deficit figure.
- **Recommendations** – each area for which a recommendation is being made should have its own section, including objectives, assumptions (if not already covered), current position, recommendations, summary, and action points.
- **Disadvantages** – any additional downsides or risk as a result of the recommendations.
- **Other issues** – this covers areas which may have come up, or which were identified by the financial planner but are not included in the recommendations, such as making a will if the client is intestate. This section will list each of those areas covering what needs to be addressed and will state how and when they will be addressed.
- **Action plan** – a summary of all the recommendations made (including advice, and product and transaction costs) and of the action points from the various areas of the plan. It should include information on what happens next, who is responsible for completing each action, and the timescales for completion.
- **Reviews** – this includes information on the purpose and importance of reviews. It will recommend an approach to reviews, including timescales, as well as how, and by whom, the review will be initiated.
- **Other relevant people** – it may be that a client has an accountant or an adviser that helps them specifically with investments. It may be important for the financial planner to make contact with these third parties to elicit certain information.
- **Appendices** – it is important that a financial plan is easily digestible by the client; any information that may break the flow or complicate the main body of the financial plan may be placed in appendices. Examples may include fact find information, **risk profiling** results and cost schedules.

This is a useful section that holds detailed information that the client may need to refer to, perhaps to understand the technical aspects of a product type or to see how figures have been derived. Reference should be made in the main body of the financial plan to any information placed in the appendices, so that the client knows where to look for it.

Care must be taken to ensure that the amount of information in the main body of the report is sufficient for it to flow and read well. The information contained in the appendices serves as useful back-up information should the client wish to refer to it.

For example, regarding a client's income tax position, the main body of the plan could include high level information such as an estimate of their liability to income tax in a particular tax year and the statement that the client is a higher rate taxpayer. If the client wanted to see the full details of how the figure was arrived at, this could be attached as an appendix with a note within the report of where it can be found.

1.2 The Nature of a Professional Relationship

Learning Objective

1.2.1 Understand the scope of the adviser's authorisation including: responsibilities; terms of business; nature of the advice process; ethical codes; authorised status and listing on the FCA directory; limitations on the advice the adviser is authorised to give and circumstances in which clients should be referred to a specialist

1.2.2 Understand ethics and codes of practice as they relate to financial planning and financial planners: professional bodies' codes of practice and ethical codes; continuing professional development (CPD) requirements

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A financial planner is a qualified professional being paid for their skills, qualifications and experience. This means that a planner has a duty of care to the client to discharge their duties in a competent manner and act in the client's best interests.

The obligations of the planner can be broken down into two categories:

1. Regulatory duties.
2. Contractual duties.

The Financial Conduct Authority (FCA) maintains a published handbook of rules and guidance. The Handbook sets out the standards which it expects firms and individuals to follow when providing regulated financial services to a client, and this can be accessed via the FCA's website (www.fca.org.uk).

The specific provisions cover a vast range of regulated businesses and are far too lengthy to reproduce in detail. However, both regulated firms and individuals acting in an approved person role are subject to a series of principles by which they must abide when carrying out their business. The 12 general principles for business are as follows:

1. A firm must carry out its business with integrity.
2. A firm must conduct its business with due skill, care and diligence.

3. A firm must take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems.
4. A firm must maintain adequate financial resources.
5. A firm must observe proper standards of market conduct.
6. A firm must pay due regard to the interests of its customers and treat them fairly.
7. A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading.
8. A firm must manage conflicts of interest fairly, both between itself and its customers, and between a customer and another client.
9. A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.
10. A firm must arrange adequate protection for clients' assets when it is responsible for them.
11. A firm must deal with its regulators in an open and cooperative way and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice.
12. A firm must act to deliver good outcomes for retail customers.

The principles for approved persons are as follows:

- An approved person must act with integrity in carrying out their accountable functions.
- An approved person must act with due skill, care and diligence in carrying out their accountable functions.
- An approved person must observe proper standards of market conduct in carrying out their accountable functions.
- An approved person must deal with the FCA, the PRA and other regulators in an open and cooperative way and must disclose appropriately any information of which the FCA or the PRA would reasonably expect notice.
- An approved person performing an accountable higher management function must take reasonable steps to ensure that the business of the APER employer, for which they are responsible in their accountable function, is organised so that it can be controlled effectively.
- An approved person performing an accountable higher management function must exercise due skill care, and diligence in managing the business of the APER employer for which they are responsible in their accountable function.
- An approved person performing an accountable higher management function must take reasonable steps to ensure that the business of the APER employer, for which they are responsible in their accountable function, complies with the relevant requirements and standards of the regulatory system.

More recently under the Senior Managers & Certification Regime (SMCR), the FCA has brought into effect the code of conduct (COCON) rules. These apply to most staff of FCA-regulated financial planning firms who are involved in the day-to-day performance or oversight of those activities. This includes those who are not approved persons.

There are five main principles on which the code of conduct is based. In summary, those within its scope are required to:

1. act with integrity
2. act with due skill, care and diligence

3. be open and cooperative with the FCA, the PRA and other regulators
4. pay due regard to the interests of customers and treat them fairly, and
5. observe proper standards of market conduct.

There are a further four additional principles which apply to those undertaking relevant senior management roles. The holders of such roles must:

1. take reasonable steps to ensure that the business of the firm for which they are responsible is controlled effectively
2. take reasonable steps to ensure that the business of the firm for which they are responsible complies with the relevant requirements and standards of the regulatory system
3. take reasonable steps to ensure that any delegation of their responsibilities is to an appropriate person and that they oversee the discharge of the delegated responsibility effectively, and
4. disclose appropriately any information of which the FCA or the PRA would reasonably expect notice.

Under the SMCR, the requirement for advisory staff to be registered as approved persons with the FCA was dispensed with. This was replaced by the code of conduct, which places greater emphasis on the correct behaviour of the financial planner and on their accountability for their actions and behaviour. Instead, their own firms will hold responsibility for maintaining an appropriate record of all of their advisory staff and monitoring their ongoing fitness and propriety.

This removal does not apply to staff who also hold senior management or significant influence functions within the firm. Those performing such functions will still need to be registered with the FCA under the SMCR. Examples include directors, partners, compliance officers, money laundering reporting officers and senior finance, risk and audit staff.

Individual advisers may also be members of professional bodies, such as the Chartered Institute for Securities & Investment (CISI). Such bodies are also likely to have their own codes of conduct and ethics, which their members will be expected to abide by when discharging their duties.

The Financial Planning Standards Board (FPSB's) financial planner code of ethics and professional responsibility sets out eight principles that express in general terms the professional and ethical behaviour that financial planning professionals should adhere to in their professional activities.

The planner must:

1. place the client's interests first
2. provide professional services with integrity
3. provide professional services objectively
4. be fair and reasonable in all professional relationships, disclose and manage conflicts of interest
5. act in a manner that demonstrates exemplary professional conduct
6. maintain the abilities, skills and knowledge necessary to provide professional services competently
7. protect the confidentiality of all client information, and
8. provide professional services diligently.

In addition, advisory staff and those firms employing them are required to follow the FCA's Training & Competence (T&C) regime. Prior to being able to advise clients unsupervised, all advisory staff are required to pass an appropriate examination and to be signed off as competent under the firm's T&C

scheme. The firm is expected to monitor their ongoing competence via methods such as pre- and post-sale file checks and other key performance indicators (KPIs).

All advisers must also undertake a minimum of 35 hours' worth of continued professional development (CPD) activity each year. Those registered as **pension transfer specialists** are required to undertaken 15 hours a year of CPD which is specific to this activity. Advisers also need to apply each year for a Statement of Professional Standing (SPS) certificate, available from their governing body such as the PFS or CISI.

Continued professional development can be structured CPD, which is designed to meet identified development needs for example training course, seminars, conferences, exam study and formal on-the-job training. It may also be unstructured, which means that the activity has met a learning outcome, but may not have been specifically designed to meet that development need. Examples may include reading industry publications and attending discussion forums.

At a higher level, there are a host of statutory instruments which are relevant to regulated financial advisers. The main acts of Parliament which govern the industry are the Financial Services & Markets Act 2000 (later amended by the Financial Services Act 2012 and the Bank of England (BoE) and Financial Services Act 2016) and the Regulated Activities Order 2001 (also amended on several occasions since). These focus on a high-level framework for the industry and establishing the activities to which that framework applies. Detailed analysis of their content is beyond the scope of this text.

A firm's contractual duties to its clients will usually be set out in its terms of business, which may also be known as a client agreement, letter of engagement or other such similar title.

The FCA requires that a firm must provide appropriate information in a comprehensible form to a client about the firm and its services, proposed investment strategies and costs and associated charges to a client. The client must reasonably be able to understand the nature and risks of the service being provided.

The content of a terms of business document is to some extent a matter of individual preference, but would commonly include factors such as:

- **Statutory status disclosure** – that the firm is authorised and regulated by the FCA.
- **Nature of the services** – what exactly the adviser is going to provide to the client as well as potentially any services which are not within the scope of the engagement, for example, a wealth manager may not provide mortgage or protection advice. Also, when and how the terms are going to come into force.
- **Remuneration** – this would set out how the planner is to be remunerated for each aspect of their services, for example, percentage of assets, flat fee, hourly rate or commission (the latter no longer being permitted for investment products).
- **Expectations of the client** – any information which the client is required to provide to the adviser and potential consequences if not provided, for example, changes in employment or marital status.
- **Frequency of review** – how often the client and the adviser intend to meet and how often a formal review of their plan will be carried out. This may also cover benchmarking, ie, how the performance of any investment portfolio will be assessed.

- **Client categorisation** – whether they are classed as a retail client, professional client or eligible counterparty, the reasons for this categorisation and the implications in terms of consumer protection.
- **Complaints process** – who to contact if the client is dissatisfied and the availability of the Financial Ombudsman Service (FOS) if they remain so.
- **Client protection** – specifically, whether the business is covered wholly or in part by the Financial Services Compensation Scheme (FSCS).
- **Conflicts of interest handling** – whether the firm is aware of any specific conflicts which may impact their ability to act in the best interests of the client and how any such issues will be handled were they to be identified.
- **General Data Protection Regulation (GDPR)** – specifically, how the firm will process the client's personal data, the length of time for which it will be kept during and after the termination of the relationship and the client's right to be forgotten.
- **Right to cancel** – how and when the client may withdraw from or cancel the agreement, the timescales involved and any financial implications involved in doing so.

Where the client considers that the adviser has not complied with any regulatory or contractual duties (eg, by providing advice which was not suitable or failing to act in their best interests) there are a range of potential remedies available. The first option would normally be the regulatory complaints process, whereby the client may complain to the firm and subsequently, if necessary, to the FOS (see chapter 2, section 7.7.2 for further details).

The client also has the option to seek remedy via the courts; however, this is usually more difficult, since it necessitates proving a breach of either law or contractual obligation. The FOS, by contrast, will decide cases based on what it considers to be fair and reasonable.

The Regulated Activities Order defines the activities which fall within the scope of FCA regulation and, therefore, require authorisation to carry out. Typical activities carried out by a financial planner in the UK would include advising on investments and arranging (bringing about) deals in investments.

The types of investment which fall within the scope of the legislation are also defined and would include, for example, unit trusts, open-ended investment companies (OEICs), shares and other financial investments. However, other appreciating assets such as property, gold and art are not within the scope of FCA regulation.

Each regulated business will be issued with a scope of permission notice by the FCA, which sets out the regulated activities it is permitted to carry out and the instruments the permission relates to. In addition to its Handbook of rules and guidance, the regulator maintains a publicly available register which allows anyone to check that a firm is authorised and the activities it has permission to carry out.

A firm must be able to recognise where it does not have the necessary permissions to carry out certain types of business. While some firms will have permissions to carry out all activities under the financial planning heading, others may focus more narrowly on a specific area of expertise. For example, a specialist investment adviser may not have authorisation to advice on mortgages, protection or transfer of a **defined benefit (DB) pension scheme**. Where this is the case, should a client require advice in such an area, the business must decline to provide this or refer them to a suitably authorised specialist.

2. Collecting Client Information

Learning Objective

1.3.1 Understand the application of appropriate techniques to collect client information: elicit all relevant personal and financial information essential to the financial planning process; assessing a client's risk tolerance

1.3.2 Understand how to meet 'know your customer' (KYC) requirements

1.3.3 Be able to evaluate affordability and other suitability considerations; environmental, social and corporate governance (ESG) and religious preferences

1.3.4 Be able to analyse gaps, errors or inconsistencies in client information, subjective factors or indicators, including: use of appropriate skills when questioning information or assumptions; gaining agreement on any reinterpretation

2.1 Gathering Client Information

It is an FCA requirement to 'know your customer' (KYC); this means that, before a personal recommendation can be made, steps must be taken to ensure that sufficient personal and financial information has been collected, which must then be kept on file.

Collecting client information is the second step of the financial planning process and is vitally important, as without detailed knowledge of the client, and sufficient information, a financial planner cannot give suitable advice.

It is also important in a regulated environment that financial planners are as certain as they can be that they have acted in their client's best interests. If it cannot be evidenced that sufficient relevant customer information has been collected it will be difficult to show that they have done this (even if they have).

A financial planner needs to collect hard data, but they will also need to understand the individual and listen carefully to what their goals and objectives are.

Information must be accurate and will generally be made up of both 'hard facts' (factual information such as the client's age and income) and 'soft facts' (such as the client's personal objectives and attitude to risk).

As there is no set structure for gathering this information, it is down to the planner to find a process that works for the client as well as satisfying the KYC regulations. Questions need to be designed that enable clients to open up. In order to do this, they need to be able to trust the financial planner so they can feel confident that they can divulge to them what can be at times sensitive information. It is essential that a financial planner is able to build a relationship and create a relaxed yet professional environment.

There are two types of questions which are used to obtain the required information:

- **Open questions** – this type of question cannot be answered simply with a 'yes' or a 'no' and is used to drill down to the client's objectives and needs. An example would be 'what do you think would happen if...?'
- **Closed questions** – this type of question is used to determine very straightforward information. An example would be 'what is your date of birth?'

In order for a client to feel relaxed and open to a discussion, the financial planner must avoid the use of excessive industry jargon as this can be intimidating for some clients. Communication with clients should be clear and understandable from their perspective.

Some financial planners email a fact-find questionnaire to their clients in advance of a face-to-face meeting. This gives the client time to think about the type of information required and to collect any relevant paperwork, such as payslips and pension statements. Completion of the document can then be carried out during the meeting.

A number of financial planners also use secure web portals for the purposes of exchange of information, allowing the client to complete a lot of the fact-finding requirements in advance of the meeting. This means that the adviser can concentrate on the discussion and planning rather than data collation and can review prior to the meeting. Integration can also allow for a risk profiling tool to be completed prior to the meeting.

Fact-finding needs to uncover the following information:

Personal information	Name and address **Domicile**/residence Date of birth Marital status Details of any dependants Health status, including whether they are a smoker or non-smoker Employment details such as occupation, name of employer, benefits in kind, whether or not self-employed Tax status Rate of tax payable Knowledge and experience.
Financial details	Income from all sources: • **Expenditure** – all outgoings, including debt/credit card repayments • **Assets** – property, savings, investments • **Liabilities** – mortgages, loans, credit cards • Savings and investments • Pensions • Any protection contracts eg, life insurance, critical illness cover.

Objectives	What the client is hoping to achieve What is important to them What is not important to them.
Attitude to risk	How much risk they are prepared to tolerate Capacity to loss – how much loss they can they 'afford' before it impacts on their day-to-day living.

Where hard facts are contradictory, this may be as simple as pointing out the contradiction and asking the client to clarify or explain it if required.

Example

Paul has stated that he is a basic rate taxpayer. However, he provides a copy of his P60, which shows an earned income of £45,000 and a bonus of 10%. He also provides dividend vouchers from his share portfolio confirming total dividend income of £5,000 for the year.

This is very likely an innocent error based on Paul, who is not a financial professional, considering his earned income only. The correct response from Paul's planner would be likely to be to draw his attention to the issue and ensure he is aware of the potential for any further income to be taxed at a higher rate, given of course that future bonuses and dividends are not guaranteed.

Sometimes, this may prove more difficult when the adviser suspects that they are not being told the full story, for example a client who is looking for a mortgage and has a deposit available of £50,000, which they claim to have been saved from surplus income, whose bank statements, however, show that they consistently spend all of their earnings.

Asking questions such as this may prove difficult as a planner's natural tendency is to look to build a rapport with existing or potential clients and, therefore, they may be inclined to shy away from asking searching questions for fear of being seen to be casting aspersions on the client. However, ultimately, significant discrepancies need to be addressed. In scenarios such as this, the planner also needs to consider their responsibilities under financial crime legislation and whether an internal suspicious activity report may be in order.

Where contradictory responses are given in terms of soft facts, this may mean asking the question again in a slightly different way so that the client is more likely to understand it, or asking further open questions designed to elicit further information on their exact feelings. It may also involve considering their practical experiences and whether what they state to be their belief now would be likely to be borne out in fact.

Example

Josie is aged 35 and has just received an inheritance of £50,000 following the death of her grandfather. She has no existing investments other than her employer pension, which she saves 10% of salary into with matched employer contributions. Her pension contributions are invested into a global equity fund on the advice of her family, given that she will not be able to access the funds for at least another 22 years. She occasionally glances at the value of her fund, but does not monitor its performance on a regular basis.

She has responded to her financial planner's risk profiling questionnaire by stating that she considers herself to have an adventurous approach to risk as her pension fund is high risk. However, she has then stated that she would be uncomfortable with losses exceeding 5% of the value of her inheritance.

In the above example, Josie's financial planner needs to explain the risk-reward trade off to her. Fundamentally, the greater the level of risk she is ready and able to take, the greater the potential rewards over a long period of time. However, the greater the risk level, the greater the potential for significant volatility in the short-run. Therefore, if she is likely to access within the foreseeable future and therefore has limited capacity for loss then taking a high degree of risk would not be appropriate.

An investor who is unwilling to see a fall in the value of their assets of more than 5% would not generally be classed as someone who is adventurous.

However, there may be behavioural finance considerations in play here. Josie's pension fund is a pot of money for a retirement which may seem a long way off and which she cannot access for a minimum of 22 years. Therefore, it is human nature that she may be less concerned about fluctuations in its value than she would be a pot of money which she may want to access at any time (an example of mental accounting).

This may also be an example of the endowment effect coming into the equation. Josie has been left the inheritance by her grandfather and may to some extent view it as his legacy to her and that she would be letting him down or squandering it if she were to invest and lose money. For the planner, it is about asking the right questions to get the full picture. For example:

> *'History shows us that over a period of hundreds of years, the average stock market return is 9% per annum. On most occasions, drops of 10% or more are followed by a significant rebound which more than compensates within a period of 3–4 years. Whilst investment returns are never guaranteed, do you feel you would be more able to feel comfortable with losses of 10–20% knowing this, or is limiting potential losses of the utmost important to you?'*

On occasions, a client may refuse to provide information. The response of a financial planner needs to be considered and fact-based. While the desire for privacy in some areas of one's affairs may be natural, a financial planner is engaged in order to provide advice and recommendations on the best way to manage the client's finances and any advice given is likely to be limited in its effectiveness, if the planner is not being given the full picture.

Example

Ikra is a financial planner who has just seen a new potential client aged 55, who is looking for investment and pension advice in the run-up to her retirement. The client appears particularly sensitive and when asked about her state of health and her income replied each time with the answer *'I don't think that's any of your business, do you?'*

When considering the client's state of health, Ikra has a decision to make. One possible course of action would be to engage with the client, but provide warnings, ie, that her advice can only be based on the information available to her and may have been different had the potential client chosen to disclose full details of her health position.

When considering the refusal to disclose her income, the position is more clear cut. It would be virtually impossible for any responsible financial planner to provide advice on funding and/or drawing from a pension to client without information on the client's relevant UK earnings and overall taxable income. This should evidently be explained to the potential client first off. However, should she persist in her stance then the only responsible course of action would be for Ikra to walk away from the engagement.

2.1.1 Customers in Vulnerable Situations

On occasion, when a firm is gathering information from a client as part of its KYC process, information may come to light which suggests that the client may be in a vulnerable situation. Such circumstances may be temporary or permanent in nature.

The FCA defines a **vulnerable customer** as:

> *'Someone who, due to their personal circumstances, is especially susceptible to harm, particularly when a firm is not acting with appropriate levels of care'.*

The FCA has carried out a substantial amount of thematic work in relation to vulnerable customers. It has identified four key drivers of vulnerability, which are as follows:

- **Health** – for example, physical disability, severe or long-term illness, hearing or visual impairments, mental health condition or disability, addiction, or low mental capacity or cognitive disability.
- **Life** events – retirement, bereavement, income shock, relationship breakdown, domestic abuse and caring responsibilities.
- **Resilience** – low or erratic income, over indebtedness, low savings, or low emotional resilience, business failing or in a precarious position.
- **Capability** – low knowledge or confidence in managing finances, poor literacy or numeracy skills, poor English language skills, learning difficulties, poor or non-existent digital skills and no or low access to help or support.

The FCA's recent Financial Lives research estimated that 27.7 million adults in the UK now demonstrate at least one characteristic of vulnerability. This has been exacerbated by the events of recent years, including the Covid-19 pandemic when many people found themselves unemployed or taking home a reduced income and the recent cost of living crisis.

The main concern firms face when dealing with vulnerable customers is that their circumstances may dictate that they are not thinking rationally or in the correct frame of mind to make substantial financial decisions. Specifically, they may be more prone to short-termism and to making knee-jerk decisions that they would not normally make on the back of recent experiences.

The FCA expects the firms it regulates to have appropriate systems and procedures in place to identify customers in vulnerable circumstances and appropriate management information (MI) to evidence that such customers are being treated fairly. With this in mind, soft facts take on a whole new and increased importance. In a lot of cases, it is only by delving into the personal lives, thoughts and feelings of their clients that a financial planner will become able to identify such circumstances.

Where vulnerable circumstances are identified, the firm will then need to deal with the matter in a manner that it sees fit. This may vary according to the circumstances, but possible measures may include offering accompaniment, reflection time, or delaying taking any significant decisions until the client is in a more appropriate frame of mind.

The FCA set out its expectations for firms coming into contact with vulnerable customers in detail in its paper '*Guidance for firms on the fair treatment of vulnerable customers*', which was published in February 2021.

2.1.2 Behavioural Finance

Behavioural finance is another area relevant to client decision making capacity which has been the subject of much academic research in recent years. Researchers have identified a number of behavioural biases which may result in clients making decisions when an entirely rational observer may have acted differently. The key impact of behavioural bias theory is that it challenges the assumption that markets are always efficient, since behavioural bias implies that investment decisions are not always made rationally.

Whilst not exclusively relevant to vulnerable customers, some behavioural biases may be exacerbated as a result of circumstances or relevant experiences. Therefore, a financial planner always needs to be careful to examine the reasons behind a client's thought process and decision making and question these where they may not appear entirely rational.

Some commonly exhibited biases are as follows:

- **Hindsight bias** – the tendency for clients to look back at past events, specifically those which have caused them financial loss, and convince themselves that events which could not have been foreseen at the time were, in fact, obvious and that they ought to have seen them coming.
- **Regret** – following on from the above, it has been demonstrated that the majority of investors will experience negative emotions when they have lost money, which are stronger and longer lasting than the positive emotions they experience when gaining the same amount. This can lead to excessive loss aversion when making future financial and investment decisions.
- **Loss aversion** – in simple terms, this occurs where a client is so averse to taking risk and losing money that they prioritise ensuring they do not make losses, even where past evidence suggests they will be worse off overall in the long term as a result of doing so.

A basic example would be investors who would rather keep their savings in the bank, where they will not lose value, rather than invest in the stock market where they may because they see it as safer. This tends to occur in inexperienced investors despite the fact that cash savings run the risk of losing value in real terms due to inflation and despite decades of empirical evidence which show that in the long run they will almost certainly be better off as a result of investing.

- **Anchoring** – this is a variant on loss aversion which can result in clients holding onto underperforming investments for too long. When an investment has lost money, this can cause the investor to become 'anchored' to the original cost of it and fail to sell it even where it is clear that there are better options available because they do not want to realise a loss. This can result in their missing out on superior investment opportunities.
- **Confirmation bias** – whereby a client with strong beliefs in a particular respect will often tend to place greater weight on evidence and information which confirms those beliefs. This can result in inappropriate rationalisation of red flags or information which may call their existing beliefs into question. Confirmation bias can result, for example, in investors holding under-diversified portfolios and also a disproportionate holding of the shares of the company for which they work.
- **Framing** – clients can also be susceptible to their viewpoint being altered depending on how things are presented to them. This can be from either friends and colleagues, the provider or government and other advice services. This is commonly found in the defined benefit transfer market, where clients who have received a transfer value statement simply look at this in isolation as akin to winning the lottery. It is easy to become blinded by the numbers, without weighing this against what they would be giving up.
- **Overconfidence** – research has also indicated that a lot of investors tend to overestimate their own skill in picking investments. In reality, investors are not party to any information which is not known to the market overall and if they were then to trade on that basis, it would be a criminal offence. Returns on an investment are usually driven by the way the business or fund in question is managed and external political/economic factors which determine market sentiment.

  Very few investment professionals have shown the ability to consistently beat the market, let alone members of the public, and the key to ensuring successful investment returns is generally time in the market as opposed to timing the market. Basically, the longer the client can afford to keep their capital invested, the more time they have to ride out short-term volatility and the greater the likelihood of returns returning to the mean. However, this does not prevent a significant proportion of clients from exhibiting the conviction that they know best.
- **Herding** – put simply, herding is the tendency for investors to 'follow the crowd'. This is notorious as one of the main causes of the bubbles and crashes which can characterise some stock markets. Where a number of investors decide to sell a holding and its price drops as a result then the rest of the market can become 'spooked' by the losses they experience and look to sell the holding before it loses any further value, which then perpetuates the drop in value. Conversely, where a number of investors buy a stock and it rises quickly in value then others tend to see the attractive returns and see the stock as an attractive proposition.

  This can result in investors losing sight of fundamentals such as the capital position and the brand loyalty and resilience of the business and simply following the crowd. In reality, this often goes against one of the overriding principles of investment which is that you should aim to buy low and sell high.
- **The endowment effect** – this can arise when clients tend to place more value on assets that they already own than on those that they do not. This can result in them holding onto assets which they would not now proactively look to purchase if they did not own them. A common explain would be clients who have received assets as a gift or a legacy from family members become 'attached' to them for that reason and are therefore reluctant to sell as they feel it would be betraying the

legacy. This can result in their refusing to cash in, even where it is clear that the investment is underperforming and that there are better opportunities available.

- **Mental accounting** – the tendency for clients to subconsciously allocate their money to 'pots' according to where it came from or what they intend to use it for. The client's attitude towards how they use the funds can vary irrationally based on this, even where it is ultimately to the client's detriment.
- **Familiarity bias** – this often leads investors to go, or stick, with investments that they are familiar with and understand well, even where this may leave them exposed to a lack of diversification or mean that they pass up on better opportunities. It also commonly arises in clients who may have significant holdings in family businesses.
- **Short-term bias** – clients often want and prioritise immediate gratification, even if it may be to their financial detriment in the long run. This can result in, for example, purchasing consumer goods such as cars on credit at very high rates of interest as opposed to making do with what they have until they can save sufficient money to purchase outright. It can also result in delaying investing/saving for retirement.

Most of the information within the personal section is self-explanatory, but some may warrant further discussion. For example, if a client is domiciled outside of the UK, this will have an impact on their tax position. Equally, establishing marital status is important as married clients will have different needs to those that are single or in long term relationships. Marital status can also have implications for tax planning including income tax, **capital gains tax (CGT)** and **inheritance tax (IHT)**.

Equally important is the issue of dependants: if the client has children, then their ages will be relevant to establish the level and likely timescale of dependency, both of which will be important when considering protection needs. Dependants could also include older parents or other family members who are not able to look after themselves.

Establishing employment status can lead to the uncovering of further information such as whether the client is a member of a company pension scheme. If they are, then this will lead to further questions, such as the level of pension contribution being made by them and the employer, whether they know what the current fund value is, or the amount of pension benefit they will receive (a current statement of benefits is most useful).

Often employers will provide 'death in service' benefits with their pension arrangements which would impact on advice about protection products. Other employee benefits might include sick pay which would also impact on discussions surrounding income protection should the client suffer illness or disability.

Establishing the level of employee benefits is clearly vital, not only because it can be taken into account when calculating any shortfalls, but also because it highlights to the client that these benefits will be lost should they leave that employer.

If the client describes themselves as 'self-employed', then this could mean that they are a sole trader working alone or it could mean that they have a much bigger business employing several people. They may not have the benefit of a company pension scheme, sick pay or death in service benefits, and so it will need to be explained to the client that each of these will have to be personally funded.

During the process, a financial planner should determine the level of financial planning knowledge that the client has by uncovering their past experiences. This may give the planner an early indication of the level of risk that the client might be comfortable with taking.

For example, if they are an active investor in shares, this might suggest an adventurous attitude to risk. This should be investigated further to gain more of an insight into their understanding of, and willingness to take on, investment risk and their capacity for loss on any investment that they make.

Capacity for loss is the client's ability to absorb any fall in the value of an investment; if any loss of capital would have a detrimental effect on their standard of living this should be considered and recorded.

When it comes to financial matters, not only will full details of income need to be established, but also a complete picture of any debt. This might include a mortgage and, if so, further details should be determined such as the interest rate they are paying, whether they are on a variable or fixed rate, whether the mortgage is repayment or interest only, and how long it is until redemption.

While hard facts can be easily collected using a fact-find questionnaire, soft facts need to be carefully extracted using a series of linked questions or by 'painting a picture' using different scenarios to gently lead the client into thinking about how certain situations would make them feel.

All information received from the client, whether hard facts or soft, should be very carefully and accurately recorded as it is this information that will form the basis of the financial plan. It should be collated in such a way that it can be presented back to the client for them to verify and point out any areas of ambiguity, or any misunderstandings or mistakes. It is not unknown for questions or information to be misunderstood and, although some mistakes can be corrected during the client meeting, some may not emerge until later analysis. It is important to be clear on what a client means, and if some of their answers to questions are vague or unclear then it is up to the financial planner to ask further questions to ensure clarity and accuracy of understanding.

The KYC record provides an ongoing and updated bank of information, which helps to structure discussions and ensures that there is a permanent record of the client's financial position at the point in time when the advice is given.

It not only satisfies the FCA's KYC requirement, but it also provides a very useful tool to help both the client and the financial planner in achieving an agreement on how their relationship will develop and helps the adviser analyse the impact of external changes such as taxation or inheritance rules, on the client. It highlights important areas of financial planning which could have dramatic consequences, good or bad, for the client.

At analysis stage, it could be that gaps or inconsistencies in the information collected may become apparent. It is vital that these are dealt with, either by looking back through previously collected client information, or by contacting the client for clarification.

If a client declines to provide relevant personal and financial information, the consequence is that a product recommendation could be of little or no use, or the client's exposure to risk could be magnified. Moreover, if a client declines to give information that is relevant, then no advice can be given in the first instance – as suitability cannot be established. Suitability requirements are found in COBS 9. Suitability can only be assessed once all pertinent financial information has been obtained.

Example

A client has a pre-diagnosed medical condition, a high level of credit card debt, their job is under threat of redundancy, and they hold all investments in shares of their employer plus a self-invested pension plan (SIPP) holding only the shares of the employer.

The client wishes to purchase accident, sickness and unemployment (ASU) insurance without disclosing their personal and financial information and perceives their financial position as low risk due to investing heavily in a company they know and trust.

The client's employer goes into liquidation, they are made redundant and the value of the shares becomes negligible. The ASU product they bought is worthless in terms of paying off the debts as prior threat of redundancy is a common exclusion. The result for the client is that not only have they got a product that does not meet their requirements but, by not informing the planner of their financial situation, they have not been offered other financial options to diversify their investment holdings. Consequently, the client loses income from employment, plus savings from investments including the entire pension pot.

2.2 Risk Profiling

When conducting a fact-find appointment, one of the most difficult areas to cover is risk, yet it is one of the most important concerns.

There are three aspects to risk profiling, namely:

- appetite for risk
- risk tolerance, and
- capacity for loss.

Risk appetite can be defined as the amount and type of risk that an investor is willing to take to meet their objectives. Risk tolerance is the degree of variability in investment returns that an investor is able to withstand. Capacity for loss is the acceptance of an investor to accept falls in the value of their investments or the ability to withstand a financial loss – this is an objective exercise whereas the other two are subjective.

As part of the fact-find process, the financial planner will have asked the client questions around experience and knowledge they have had with risk, either with their own investments or in their personal lives. For example, if someone has previously made a lot of money on the stock market they might see this type of investment as being less risky than someone who has lost a lot of money.

Assessing a client's appetite for risk, and matching it to their objectives, is a fundamental part of financial planning. Typically, the higher the risk taken, the greater the potential financial return. There is a direct relationship between risk and return, known as the risk-return trade off.

Risk profiler questions should be clearly worded; if they are not, then the danger is the client can give answers that do not accurately reflect the risk they are willing and are able to take.

The use of third-party risk profiling systems has increased in recent years; the financial planner is still responsible for ensuring that their personal recommendations are suitable so any tools, such as risk assessment profiling tools to assess knowledge and experience, must be fit for purpose and designed for use with their clients.

The appropriate level of risk can only be selected once a full account is taken of a client's personal circumstances, including their age, their level of income, their protection needs, their level of debt, their investment time horizon, their future aspirations and their capacity for loss.

Time horizon is crucial, for example, portfolios can be more exposed to a higher equity content to maximise returns when the client has a long way to go before retiring or needing the money. As the client gets closer to when they need the money (or retirement), funds can be moved away from higher risk assets to give more exposure to fixed interest investments or lower risk assets.

Diversification of investments is a key part of managing risk, so it is essential that a full picture of the client's assets is known so that an assessment of current risk exposure and degree of diversification can be made.

Financial planning is all about satisfying the client's financial and lifestyle objectives, not the financial planner's objectives (or the objectives that the planner thinks the client should have). However, during the analysis stage, the financial planner may identify further issues and problems that the client may not be aware of. These should be clearly stated in the financial plan, together with any recommendations and actions that the client may need to take to resolve them. Even if recommendations are not being made, the issues and problems should be recorded so that they can be raised and dealt with at a later meeting. These could well become objectives after discussion with the client.

In summary, financial planning falls into the following categories:

- **Protection** – protecting current and future living standards by safeguarding income against unexpected events, such as illness, an accident, redundancy, rises in the cost of debt, and death.
- **Pensions** – ensuring that sufficient income and/or capital is in place to achieve a comfortable standard of living in retirement.
- **Savings and investment** – including tax-efficient savings for future goals, starting a family, funding education or for retirement, including possible long-term care implications.
- **Estate planning** – ensuring that any IHT liability is mitigated as much as possible with the use of available reliefs and exemptions, and that funding is in place for any residual liability. Here we should also consider whether the client is testate – ie, has a will, or is intestate – ie, has not written a will. If they have not made a will, they should be encouraged to do so and the financial plan should reinforce this. If they have made a will, then the details of this should be established, for example, who the beneficiaries are and whether it still suits the current position of the client.

It is important for a financial planner to recognise that the client's perception of their needs may be tainted by factors such as limited knowledge of the financial products that are available, a lack of understanding or knowledge of alternative options, some previous personal experience, and the experiences of family and friends.

Perception can change radically through knowledge and understanding and, in this, the financial planner plays a key role in both educating clients and, through effective fact-find processes, building a complete picture to identify real, as opposed to perceived, needs.

Clients can also be heavily influenced by psychological factors. As we have already seen, behavioural finance (see section 2.1.2), the study of how psychology affects financial decisions, has become more and more important over the last 20 years. For example, it has shown that individuals tend to be over-confident in their own abilities which has led to wrong decisions being made regarding investment. Equally, 'loss aversion' can result in clients selling profitable investments and holding onto investments that are showing losses. It seems that admitting to a loss is too painful, so we ignore it and hope it goes away.

Financial planners need to consider the potential for these behavioural biases and help clients overcome them by evaluating their decision-making styles, learning to work around them and reduce their influence to ultimately help them to arrive at a more rational decision.

Part of the fact-find process is establishing goals and objectives, which can also be a challenging part of the financial planning process.

2.3 Affordability and Suitability

Once goals and objectives have been established, it is important to evaluate the amount of available capital and any surplus income that the client has towards meeting their goals and objectives. Any recommendations made in the financial plan must be affordable. If it becomes apparent that there are insufficient funds to deal with all of the established goals, then they must be prioritised. Affordability will also include an assessment of liquidity and time horizon. All portfolios should have a level of cash which can be drawn upon in an emergency but, beyond this, if someone needs more liquidity than this, it will reduce the risk that can be taken with available funds. Similarly, if someone has a very short time horizon before needing funds, this will mean that the priority will be preserving the value of capital.

Cash flow forecasting is an important aspect of establishing affordability and is covered in more detail in section 4 of this chapter.

The FCA rules on suitability mean that a financial planner must obtain the necessary information regarding a client to make sure that the product/transaction or service being recommended:

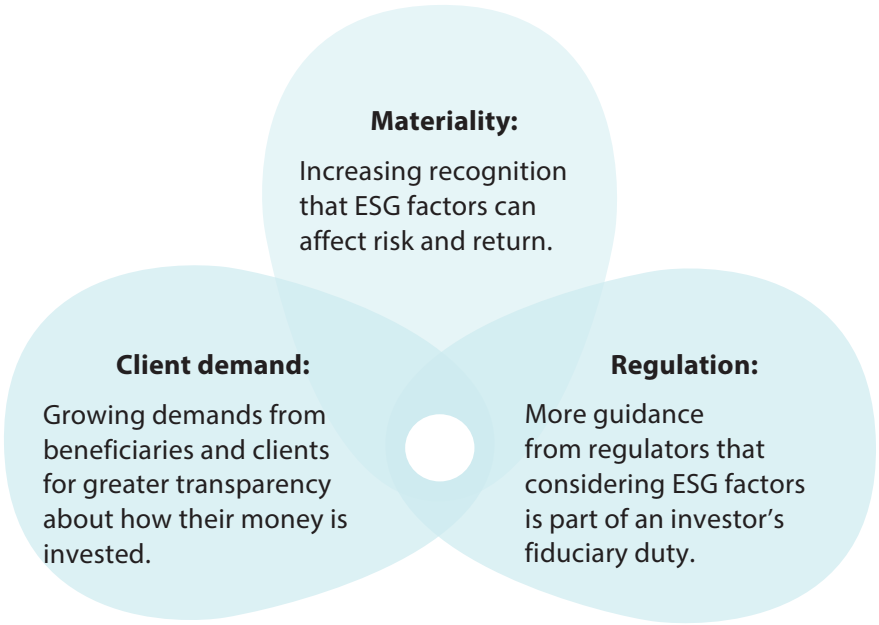
- satisfies the client's investment objectives, including their risk tolerance
- satisfies the client's capacity for loss, and
- is within the client's levels of knowledge and relevant experience to understand the risks involved.

A financial planner should obtain explicit confirmation from the client that they understand the nature and extent of the service and confirmation that the information they have provided is correct.

2.4 Special Considerations in Evaluating Suitability

Investing in positively impactful ways has increased in investors' priorities, especially as climate change and company mismanagement has become more visible in recent years. Many investment managers have taken environmental, social and governance (ESG) factors into consideration for their investment analysis and decision making for many years with an aim of achieving better long-term returns. Investor focus has increased rapidly over a very short period of time. Assets invested into 'sustainable investments' increased substantially, in particular following the emergence of the coronavirus (Covid-19) pandemic and investors developing an increasing awareness of environmental concerns, often described in the UK as the 'David Attenborough affect'.

Immediately prior to Brexit, it was thought that the amendments to MiFID in respect of adviser obligations in this area would be carried across into the UK legislation. These rules were, firstly, that an adviser would be obligated to ask if a client had any 'ethical' preferences, but, secondly, even if the client said no, the adviser would need to consider the risks for the client anyway. The changes to MiFID were due to come into force in March 2021, so as the UK exited the EU in December prior, the rules were never brought into force. However, the Treasury has said that the UK will have the equivalent rules and regulations here. What is very clear is that regulation in this area is only likely to increase.



Source: What is responsible investment? | Introductory guide | PRI (unpri.org)

Historically, investing with any particular 'ethical' preference meant that the client usually had to sacrifice either by paying more, accepting a higher level of risk or accepting a lower return; this is no longer necessarily the case. Integrating ESG into the investment decision-making process is widely acknowledged to lower risk and increase returns. Businesses which have poor credentials in this area at some point are likely to have their profits hit; for example, BP paid out $53.8 billion following the Deep Water Horizon oil spill in 2010 and Volkswagen paid out $27.5 billion in fines following the rigging of 11 million diesel vehicles to pass carbon emissions tests. As the world transitions to a carbon-neutral economy, the spectre of 'stranded assets' looms. Over the next decade, renewable energy will be cheaper to generate than that driven by fossil fuels. The likelihood is that it will no longer be cost effective to mine coal and unless businesses can adapt, they will become bankrupt.

Clients, typically, have many conflicting priorities and values. The starting point for an investor is understanding their chosen investment approach and whether it is aligned to their values and balanced with any other financial priorities. An ESG disclosure document will certainly help an adviser in their discussions with the client. ESG disclosure documents such as those developed by FE Investments' help a client to understand the following:

- High level allocation to major positive and impact themes.
- Alignment to the UN Sustainable Development Goals.
- Environmental and social impact at company level.
- ESG controversy exposure.
- Negative screening exposure.

For the majority, a degree of compromise and pragmatism is acceptable for clients, for example, excluding nuclear power entirely may mean that exclusion to a company that is at the forefront of renewable energy generation cannot be in the portfolio on account of a legacy power plant. However, for some investors, the investment will need to completely reflect their values.

2.4.1 ESG Funds

In practice, ethical funds operate by giving weightings to areas of corporate social responsibility and ranking companies according to those weightings. The key principles used by the fund may not exactly match those of the investor, however, and so it is important that the client is made aware of this.

Funds are often categorised by shades of green: light green being the loosest criteria and dark green being the strictest. It is important to match the approach taken by the fund to the principles of the client and their risk profile.

Historically, the majority of fund managers have used what is known as negative screening, where the manager seeks to exclude companies or industries perceived as having a negative impact on society. In recent decades, however, there has been a trend towards positive screening, whereby fund managers actively seek out those companies with a best-in-class approach towards social responsibility and human or employee rights.

The interest that many companies have shown in demonstrating solid standards of corporate responsibility, such as support for local communities and environmental factors, started, in part, as a result of the growing power and influence among fund managers with responsibility for ethical and socially responsible investment (SRI) funds. It is in the interests of any company not to have its share excluded from such funds, particularly if the number of those funds continues to grow.

For some clients, the level of screening used by fund managers may be of great importance, while for others, investing in a light green fund may provide sufficient satisfaction that they are helping to influence companies in taking their social responsibilities even more seriously.

2.4.2 Shariah-Compliant Funds

Islamic investment products are also becoming more widely available. They must be Shariah compliant and so they cannot involve the payment of interest (*riba*) and cannot invest in certain areas such as gambling, alcohol, tobacco and other areas that are against Muslim beliefs. Shariah law does allow investment in equities as long as the company is not investing in areas that are not permitted. Banking products have also been adapted to be Shariah compliant. They cannot charge interest so banks use an *ijara* scheme as a leasing arrangement where it buys something for a customer and leases it to them. *Murabaha* schemes are used to provide finance on a property by agreeing a price which is more than market value. With savings accounts, instead of an interest rate, customers are offered a target profit which is achieved by investing in compliant investments.

The main difference between *ijara* and *murabaha* is that with an *Ijara* mortgage, the property will not immediately be registered as belonging to the buyer. Instead, the buyer will essentially rent the property from the lender. In addition to the agreed monthly repayment amounts, the buyer will also pay monthly rent to the bank. At the end of the agreed term or once the purchase price has been repaid in full, ownership of the property is transferred from the lender to the buyer. *Ijara*-based home finance tends to be more common for residential property.

3. Streamlined Advice

3.1 Different Types of Advice

Learning Objective

1.4.1 Know what is meant by 'streamlined advice': simplified advice; focused advice

1.4.2 Understand the key considerations in verifying client information supplied by a third-party

There are a number of interpretations of the word 'advice'. In addition, the distinction between regulated advice and guidance is not always clear to consumers yet it is an important distinction to make:

- Regulated advice is given by a qualified and regulated financial adviser.
- Guidance is where a customer is helped to make their own informed decision by receiving the information they need and does not receive advice.

The UK government has felt for a long time that the financial services market can work better to provide affordable advice and guidance for everyone.

Until January 2019, there were three government-backed providers of guidance.

- **The Money Advice Service** – this offers free and impartial information on all aspects of financial planning such as debt and borrowing through to retirement.
- **Pension Wise** – this is a free service for those aged over 50 who have a defined contribution pension scheme and need help to understand their options.
- **The Pensions Advisory Service** – TPAS provides independent, impartial and free information and guidance regarding pensions to help individuals make informed choices.

The three were merged under the banner of the temporary Single Financial Guidance Body (SFGB).

The SFGB was set up to replace the three existing providers of government-sponsored financial guidance – the Money Advice Service, the Pensions Advisory Service and Pension Wise – bringing together the provision of debt advice, money guidance and pension guidance for the first time.

The new body will deliver free and impartial financial guidance and a more streamlined service to members of the public, providing easier access to the information and guidance.

The SFGB became a legal entity on 1 October 2018 and took on its delivery functions from January 2019. SFGB is an executive non-departmental public body, sponsored by the Department for Work and Pensions.

In April 2019, the **Money and Pensions Service (MaPS)** was launched to replace the temporary name creating the new organisation and commencing the development stage of a new integrated service.

MaPS is an 'arm's-length' body sponsored by the Department for Work and Pensions, established at the beginning of 2019. MaPS also engages with HM Treasury on policy matters relating to financial capability and debt advice.

In January 2021, the UK Strategy for Financial Wellbeing was launched by MaPS. This highlighted five key agendas for change to be achieved by 2030:

- **Financial Foundations** – 6.8 million children and young people getting a meaningful financial education – an increase of two million from 2019.
- **Nation of Savers** – 16.7 million working-age people who are struggling and squeezed saving regularly – an increase of two million.
- **Credit Counts** – two million fewer people often using credit to pay for food or bills.
- **Better Debt Advice** – two million more people getting the debt advice they need; currently only 32% of those who need debt advice access it.
- **Future Focus** – 28.6 million people understanding enough to plan for their later lives – an increase of five million.

The Financial Advice Market Review (FAMR) was launched in 2015 as a result of concerns that financial advice in the UK was not working well for all consumers.

The Review looked at:

- the advice gap for those people who want to work hard, do the right thing and get on in life but do not have significant wealth
- the regulatory or other barriers that firms may face in giving advice and how to overcome them
- how to give firms the regulatory clarity and create the right environment for them to innovate and grow
- the opportunities and challenges presented by new and emerging technologies to provide cost-effective, efficient and user-friendly advice services, and
- how to encourage a healthy demand side for financial advice, including addressing barriers which put consumers off seeking advice.

Recommendations within the final report fell into three key areas, namely:

- affordability
- accessibility, and
- liabilities and consumer redress.

The FAMR recommended a clear framework to provide streamlined advice on simple consumer needs. As part of this, it recommended that the FCA should produce guidance to support firms delivering 'streamlined' advice on a limited range of consumer needs, supported by examples of good and poor practice.

The FAMR describes streamlined advice as:

> *'A term used to collectively describe advisory services (such as focused and simplified advice) that provide a personal recommendation that is limited to one or more of a client's specific needs. The service does not involve analysis of the client's circumstances that are not directly relevant to those needs'.*

The term 'streamlined advice', therefore, covers both simplified and focused advice. Streamlined advice services might also include automated 'robo-advice' (an online automated advice model) or more traditional face-to-face or telephone-based models.

Currently, there are various levels of advice.

For example, advice given to a client to buy shares in ABC plc or to sell Treasury 3% 2025 stock is advice about a specific investment and so is regulated advice.

- Advice to buy shares in the automotive sector or shares with exposure to a specific country is generic advice because it does not relate to a specific investment and is, therefore, not regulated.
- A personal recommendation relates to taking certain steps in respect of a particular investment which is presented as suitable based on a consideration of the person's circumstances.
- Simplified advice (ie, streamlined) is a personal recommendation which is limited to one or more of a client's specific needs and does not involve analysis of their circumstances that are not directly relevant to those needs.
- Focused advice (streamlined) is advice focused, at the request of the customer, on the provision of personal recommendations relating to a specific need, designated investment, or certain assets.
- Simplified advice and focused advice are the same, except with simplified advice the firm sets the boundaries of the service, whereas with focused advice the client stipulates the boundaries. Although streamlined advice services might be designed to deal with more limited client needs and may not, therefore, involve an analysis of all the client's circumstances, any personal recommendation given to a client must still be suitable. A streamlined advice offering does not enable a firm to lower the level of client protection.
- The appropriateness test is the requirement on a firm to assess the customer's knowledge and experience in the relevant investment field to determine whether they can proceed with a purchase of a complex Markets in Financial Instruments Directive (MiFID) product without advice.
- Execution-only is a service consisting of the execution of client orders relating to particular financial instruments at the client's initiative. The firm does not give any advice on investments.

The difference between the terms 'information' and 'investment advice' is down to an element of opinion or judgement on the part of the adviser. But, if information is provided on a selected rather than a balanced basis so that it influences or persuades, it is likely to be regulated advice.

As of June 2021, the Money Advice Service, Pension Wise and the Pensions Advisory Service were consolidated and rebranded into Money Helper, which is the consumer-facing brand of MaPS.

3.2 Verifying Client Information Supplied by a Third Party

Learning Objective

1.4.2 Understand the key considerations in verifying client information supplied by a third-party

Once information has been collected from a client, it is often necessary to follow up to gather further details not originally captured during the initial discussion and fact-find meeting. This often becomes apparent when preparing to write a financial plan. Often clients will have statements which may be out of date or they are unable to provide copies of policy documents which contain full details of current arrangements.

To obtain sufficient detail on policies that are already in place, it may be necessary to obtain what is known as a 'letter of authority' from the client to be sent to a product provider together with a questionnaire requesting the required detail.

The letter of authority is often valid for 12 months; it may or may not include an instruction for any servicing rights to be transferred if there is no present relationship with another adviser, or if the client is planning to change their adviser.

Information that has been gathered can only be relied upon if the adviser is certain that the information is not out of date, inaccurate or incomplete.

One of the most common examples would be when an adviser is considering consolidation of a client's pensions. In this situation, a letter of authority would be sent to each product provider requesting information on the existing scheme. This would include start date, contributions, funds and charges, but would also include, for example whether the plan has:

- A guaranteed annuity rate.
- Protected tax free cash.
- A protected early retirement age.
- Any penalties on transfer.
- Any early encashment charges.
- The full range of flexible benefit options on death, and who the nominated beneficiary is, or if an expression of wish form needs to be completed.

Options such as protected tax-free cash, guaranteed **annuity** rates and early retirement ages may be lost on transfer and where early encashment charges apply, it may be more prudent to leave the plan where it is until these have expired. Conversely, if the product does not offer the required vesting options, this may be a strong reason to recommend consolidation.

COBS 9.2.6 states that, if a '*firm does not obtain the necessary information to assess suitability, it must not make a personal recommendation to the client or take a decision to trade for him*'. This can provide problems where the information provided is incomplete or is in a standard format, which does not cover all of the issues. This can mean that the advice firm has to waste a significant amount of time going back to providers to attempt to clarify details.

Data protection regulations can often prove a barrier here. Providers require a letter of authority signed by the client and some will still insist on a 'wet' signature in ink, despite electronic signatures being legally acceptable.

Some providers will also not use modern electronic communication methods, as they are not deemed to be secure, while others insist on sending information only to the client despite the adviser's authority. Provider call waiting times are often long and some will only answer a certain number of queries per call. This can often make it a struggle to obtain sufficient information to meet the expectations of the FCA.

On occasions, the adviser may be working in conjunction with another advice firm, for example when defined benefit transfer advice is provided under the two-adviser model. In this scenario, the client's financial planner will refer them to another adviser for the purposes of receiving specialist advice on the transfer of their defined benefit pension. Should the recommendation be to transfer, then the existing adviser will recommend the investment strategy.

The regulator requires that in such situations, firms work together to obtain information that is sufficient to inform both the advice on the pension transfer and the investment advice. They are also required to obtain information from the client about their preferences regarding risk taking, which covers both investment and transfer risk, the latter being the risk associated with the loss of safeguarded benefits.

The firm is entitled to rely on the information given by a provider or another advice firm unless it is aware that it is incorrect or out of date. Records obtained from a third party are required to be kept for the minimum retention period set by the FCA in accordance with COBS 9.5. These are indefinite in the case of a defined benefit transfer, five years for a life policy or defined contribution pension scheme and three years in all other cases.

4. Analysing the Client's Financial Status

Learning Objective

1.5.1 Be able to identify the client's current circumstances, including: assets and liabilities; any foreseeable changes to their circumstances

1.5.2 Be able to calculate net worth: during lifetime; on death; on specific events such as illness, disability or retirement

1.5.3 Be able to calculate net spendable income or income shortfall

1.5.4 Be able to calculate cash flow at key life stages, including: current; at retirement; on ill health; on death

4.1 The Client's Current Circumstances

A key part of the financial planning process is analysing the client's financial position using the information gathered in the fact-find process regarding current income and future income needs as well as their tax position.

The following details will be necessary:

- **Assets** – including property, savings and investments.
- **Liabilities** – including regular commitments such as mortgage and unsecured debt.
- **Income** – from all sources.
- **Health** – to evaluate ability to work and life expectancy.
- **Expenditure** – all outgoings including debt or credit card repayments.
- **Attitude to risk** – how much risk they are prepared to take.
- **Capacity for loss** – how much can they afford to lose?

At this stage, it will be important to establish if there is any new information to change this current situation; for example, impending redundancy, a promotion or the sale of a business.

4.2 Net Worth Statement

A net worth statement shows what a client owns (assets) and what they owe (liabilities) at a particular point in time, and allows a financial planner to see, as a snapshot, the level of capital that might be available for investment. It is, therefore, important that the date when the statement was prepared is clear – this would normally be the date of valuation of the assets and liabilities.

There are no set rules to determine which assets and liabilities should, or should not, be included but it is important that the client understands why an asset or liability is, or is not, shown on the net worth statement. The financial planner, therefore, needs to ensure that clear notes are included as a way of explanation. If a particular asset is not mentioned on the net worth statement, the client will not know whether it has been deliberately excluded or has perhaps just been forgotten. At the same time, if the value being used is different to the one the client might expect, this should also be explained.

For example, it may be that the value of personal pension funds is not included because the client has not yet reached the minimum pension age, which is currently 55, albeit set to change to 57 from 2028.

Net worth may significantly change because of a change of circumstance, in particular death, illness and at retirement. On death, an asset which would not have previously shown as an asset, for example a life insurance policy, will now realise a value. Likewise, death in service benefits will add to the overall value, although there is likely to be a significant impact on cash flow. At retirement, it is likely that a lump sum will be received from a company or private pension plan. Looking ahead allows a financial planner to take account of such events to ensure that there are no unexpected surprises which might lead to a deviation from the financial plan.

Example Net Worth Statement

	Client 1	Client 2	Total Worth
Principal private residence	£400,000	£400,000	£800,000
Holiday home	£200,000	£200,000	£400,000
Investment property	£200,000	£200,000	£400,000
Personal possessions	£70,000	£70,000	£140,000
Cash savings	£25,000	£25,000	£50,000
ISAs	£174,500	£120,000	£294,500
Investments	£567,321	£250,176	£817,497
Mortgage on investment property	–£55,000	–£55,000	–£110,000
Total net worth	**£1,581,821**	**£1,210,176**	**£2,791,997**

In addition, the clients each have life policies which will be added to their net worth if they die when the policy is still in force.

	First Named	Second Named	Total Worth
Life insurance policy	£350,000	£150,000	£500,000
Net worth on death	£1,931,821	£1,360,176	£3,291,997

Assets should be listed, with any relevant facts about each noted, for example, the level of equity in the property, how the property is held, and whether held jointly or as tenants in common.

Equally, information regarding investments should be laid out in a way that identifies asset class, ownership, value, yield, the type of wrapper (eg, ISA), value at purchase, and date of purchase. One role of the financial planner is to ensure that any current investments are suitable for the client. To do this they will need to identify the purpose of the investment, whether the performance has been adequate, what the charges are, and whether the investment matches their risk profile.

The ability to prepare a net worth statement is a key skill, and different client scenarios could warrant separate net worth statements, for example:

- **On retirement** – to identify the assets available to help fund income in retirement and other objectives.
- **If the client had fallen ill yesterday** – to identify the assets available to support the client and their family.
- **If the client had died yesterday** – to identify the assets available to support their family and any related estate planning issues.

Each statement should clearly identify the scenario and the date of preparation.

The reason for producing different net worth statements for different client scenarios is that, depending on the situation, some assets may or may not be available, and some may have different values.

Here are some examples:

- **Term insurance** – this type of policy only pays out on the death of the life insured if that happens during the selected term. During the client's lifetime, it has no value.
- **Endowment policies** – these were marketed as savings plans or as a way to pay off an interest-only mortgage. They pay out if death occurs during the term of the policy and also at the maturity date. Unlike term insurance, they do build up a surrender value during the term.
- **Whole of life policy** – these policies pay the sum insured whenever death happens – they do build up a surrender value, but this will usually be less than the amount that would be paid out on death.
- **Money purchase or defined contribution (DC) pension plan** – these types of pension plan may have a significant fund value, but if the client has not reached the age at which it can be accessed, the capital is not available for general financial planning (although it will, of course, be relevant for the client's retirement planning). If the client has reached the age at which their plan can be accessed, the amount of tax-free cash (the **pension commencement lump sum (PCLS)**) could be available together with any other amount that can be withdrawn (but taxed as income). If the scenario being modelled is death, then the value of the pension fund is the amount that is payable on death which is generally the return of the fund.
- **Family home** – this may be regarded as somewhere to live by the client, rather than as an investment. A different client may intend to downsize in retirement and release equity which would then be available to invest.

4.3 Income and Expenditure

An income and expenditure analysis compares the client's incomings and outgoings usually over a period of 12 months (the planner should specify, for example, tax year, or calendar year). This analysis highlights whether expenditure exceeds income, which can highlight a build-up of debt or whether there is a surplus income. If a client is in deficit each month, then the clear priority is to get expenditure under control as quickly as possible. A financial planner can help identify areas where savings can be made.

It is important to separate the client's earned and unearned income. Details of earned income should include:

- the amount of income
- whether the client is employed or self-employed
- any additional amounts, such as bonuses or commission
- any benefits in kind
- pension contributions, and
- tax position.

Details of unearned income should include:

- the source (eg, from unit trusts, bank/building societies, shares)
- the gross amount (grossing up where relevant)
- interest or **dividends**, and
- rental income.

Other income should also be included such as child benefit, other state benefit payments and pensions, and, in the case of plans for more than one client, allocated correctly against each person.

The client's liability to income tax, national insurance (NI) and other taxes, such as the high-income child benefit charge, should be noted, as well as CGT, if relevant.

While the main body of the report should include a summary of the client's estimated income tax position, detailed income tax and NI calculations may appear as an appendix.

The tax calculations provided are generally used to provide an estimation of a client's liabilities but are necessary as part of the income and expenditure analysis so that the client's net spendable income can be ascertained. It might also raise other important planning issues such as:

- transferring assets between spouses/**civil partners** for income tax and CGT purposes
- making pension contributions
- using the transferable marriage allowance
- using tax wrappers, such as ISAs
- the tapering of personal allowance if adjusted net income exceed £100,000, and
- the high-income child benefit charge.

Income Tax Calculation Template for Tax Year

Prepared for: client name	
Calculate gross income	
Earned income (gross)	£X
Benefits in kind	£X
Savings income	£X
Dividend income	£X
Other unearned gross income	£X
Total gross income	**£X**
Less	
Charges against income (for example, allowable business losses and interest on qualifying loans)	£(X)
Charges to be deducted for personal allowance test purposes	£(X)
Statutory total income (used to test for personal allowances)	**£X**
Less	
Personal allowances*	£(X)
Taxable income	£X
Savings income within the above	£X
Dividend income within the above	£X
Non-savings income is the balance of total taxable income less savings income and dividend income	
Tax on non-savings income	£X
Tax on savings income	£X
Tax on dividend income	£X
Tax on chargeable gains from life policies	£X
Less	
Tax reducers, eg, the married couples' allowance (MCA) (where one party was born before 6.4.35) or any transferable amount of personal allowance, VCT and EIS.	£(X)
Total income tax liability	**£X**
Less any tax deducted at source	**£(X)**
Add other tax liabilities, eg, high income child benefit charge	£X
Total income tax due/tax repayable	**£X**
National Insurance contributions (NICs)	£X
Total income tax and national insurance liability	**£X**
Net income **	£X

* Personal allowances may be reduced if adjusted net income exceeds £100,000 (in 2024–25).

** Net income is total gross income less any benefits in kind, less the total income tax and NI liabilities.

If recommendations are being made that change the client's tax position, it would be worth including a calculation that shows what the difference is if the recommendations were to be implemented.

Income and Expenditure Analysis – Annual Position for Tax Year 20xx–xx

Prepared for: Mr and Mrs A Client

Gross income	£
Salary – Mr Client	XXXXX
Salary – Mrs Client	XXXXX
Building society interest	XXXXX
Dividends from quoted shares	XXXXX
Child benefit (non-taxable)	XXXXX
Other income	XXXXX
Total gross income	**XXXXX**
Income tax and national insurance contributions	
Income tax – Mr Client	XXXXX
National insurance – Mr Client	XXXXX
Income tax – Mrs Client	XXXXX
National insurance – Mrs Client	XXXXX
Income net of income tax and national insurance	**XXXXX**
Expenditure	
House (rent or mortgage)	XXXXX
Utilities	XXXXX
Food and clothes	XXXXX
Motor	XXXXX
Travel and leisure	XXXXX
Personal	XXXXX
Savings and personal insurance	XXXXX
Total expenditure	**XXXXX**
Surplus net income	XXXXX

Summary of Tax Position 2025–26: Prepared for Michael Smith

Michael is employed on a salary of £50,000 pa. In addition, he receives benefits in kind with a taxable value of £5,500 pa, and an annual bonus of £8,000. Michael is a member of his company's **occupational pension scheme** and pays a member contribution of 5% of his salary, which is taken via the net pay arrangement. Michael has £10,000 in a building society account, receiving interest of 4% pa. He also received dividends of £800.

Salary	£50,000
Bonus	£8,000
Benefits in kind	£5,500
Total earned income	£63,500
Savings income (Building Society)	£400
Dividend income	£800
Gross income	£64,700
Less charges against income (pension contribution)	£2,500
Less personal allowance	£12,570
Taxable income	£49,630
Savings income	£400
Dividend Income	£800
Non-savings income	£48,430
Income tax	
Non-savings income £0–£37,700 @ 20%	£7,540
Non-savings income £37,700–£48,430 @ 40%	£4,292
Savings income £400 @ 0%	£0
Dividend income £500 @ 0%, £300 @ 33.75%	£101.25
Total income tax liability	£11,933.25
Less income tax deducted at source	£0*
Income tax due	**£11,933.25**
National insurance contributions	
£0–£12,570 @ 0%	£0
£12,570–£50,270 @ 8%	£3,016.00
£50,270–£58,000* @ 2%	£154.60
Total NICs	**£3,170.60**
Total income tax & NICs	**£15,103.85**

* Note that the savings interest of £400 (ie, £20,000 x 2%) falls within the personal savings allowance and is tax-free. In 2025–26, basic rate taxpayers can receive £1,000 of savings income tax-free, higher rate taxpayers have an allowance of £500 and additional rate taxpayers have no allowance. In this example, deposit interest is tax-free. The dividends mainly fall within the dividend allowance of £5,000 (2024–25). However, the £300 excess would be taxable.

Example Income Tax Calculations (2)

Becky Mayer is a self-employed florist. She expects to make profits of £61,500 in 2025–26 and she also has a share portfolio valued at £100,000 which pays dividends of £6,000 pa. Becky pays £400 per month into her SIPP.

Provide Becky with an estimation of her tax liabilities and net income in 2025–26.

Income tax calculations for 2025–26
Prepared for: Becky Mayer

Profits from self-employment (estimated)	£61,500
Dividends	£6,000
Gross income	£67,500
Less personal allowance	£12,570
Taxable income	£54,930
Dividend income	£6,000
Non-savings income	£48,930
Income tax	
Gross pension contribution (400 ×12) / 0.8	£6,000
Non-savings income £0–£43,700* @ 20%	£8,740
Non-savings income £43,700–£48,930 @ 40%	£2,092
Dividends £500 @ 0%**, £5,500 @ 33.75%	£1,856.25
Total income tax liability	£12,688.25
Less income tax deducted at source	£0
Income tax due	£12,688.25
National insurance contributions	
Class 4 £12,570 – £50,270 @ 6%	£2,262
Class 4 above £50,270 (£61,500 – £50,270) @ 2%	£224.60
Total NICs	£2,486.60
Total income tax & NICs	£15,174.85
Net income (gross income less income tax and NICs)	£52,325.15
Net income (gross income less income tax and NICs)	£51,183.50
* The basic rate tax bracket is extended by the grossed up pension contribution	

* Becky's basic rate income tax band has been extended by the £6,000 pa gross personal pension contribution to £43,700. Becky is paying a net £400 per month into her SIPP. This totals £4,800 pa. Basic rate tax relief at 20% is added to this by dividing the net contribution by 0.8, which adds a further £1,200, giving a gross of £6,000. By extending the basic rate band by this amount, a further £1,200 is deducted from her tax bill. Hence, the net position is that she has paid £3,600 and £6,000 has been paid to the pension, which is consistent with her status as a higher rate taxpayer.

** In the tax year 2025–26, the first £500 of dividend received is tax-free. The tax rate for dividends in excess of £500 are 8.75% for basic rate taxpayers, 33.75% for higher rate taxpayers, and 39.35% for additional rate taxpayers.

Example Income Tax Calculations (3)

Terry Brown is aged 71. He receives a gross pension income of £15,850 pa (including SPs). He expects to receive £450 in dividends and £3,500 in gross building society interest during 2025–26.

Based on the above, estimate Terry's net income in 2025–26.

Income tax calculations for tax year 2025–26

Prepared for: Terry Brown

Gross pension income		£15,850
Building society interest		£3,500
Dividends		£450
Gross income		£19,800
Less personal allowance		£12,570
Taxable income		£7,230
Savings income		£3,500
Dividends		£450
Non-savings income		£3,280
Income tax		
Non-savings income £3,280 @ 20%		£656
Savings income	£1,720 @ 0%	£0*
Savings income	£1,000 @ 0%	£0**
Savings income	£780 @ 20%	£156***
Dividend income	£450 @ 0%	£0****
Total income tax liability		£812
Net income		£18,988

*	covered by the remaining starting rate for savings of £5,000 – 0% tax if non-savings income does not exceed £17,570 (the £5,000 allowance plus the 2025–26annual personal allowance).
**	covered by the personal savings allowance.
***	remaining interest charged at basic rate.
****	covered by the dividend allowance.

4.4 Calculating Net Spendable Income or Income Shortfall

The calculation of net spendable income or income shortfall is quite straightforward once the client's surplus (or shortfall) monthly income has been calculated.

Example

After completing a detailed calculation of a client's income, a financial planner has identified that they have an annual net income of £50,000 pa, and has established that the client spends £53,000 pa.

Annual net income	£50,000
Minus annual expenditure	£53,000
Annual income shortfall	£3,000

The financial planner should be able to identify ways in which the client can either boost net income or reduce expenditure; and these could form part of the recommendations.

For example, it may be possible for a couple to reallocate assets between them to reduce tax which can increase surplus income.

Further tax calculations may also be needed depending on the client's goals and objectives. These could include the following:

- **CGT –** if the client is considering disposing of assets or restructuring an investment portfolio.
- **IHT –** to establish the liability in the event of the client's death. Planners should prepare separate IHT calculations for each partner (eg, on A's death assuming B has died first and on B's death assuming A has died first). This will ensure that assets such as death in service cover, pension death benefits and life insurance written under trust are treated correctly.

Any immediate ideas to reduce inheritance tax liabilities should be recorded in the financial plan. This stage of the analysis of the client's circumstances may also raise some further issues and, again, these should be recorded in the financial plan to show that they have been considered, even if a conclusion is not reached at this time.

It is important to keep up to date with changes in the tax system. For example, for the 2025–26 tax year, it was announced that there would be significant cuts to national insurance rates and compulsory class 2 national insurance for the self-employed would be abolished.

If someone dies and their estate is worth more than the basic inheritance tax threshold, their estate may qualify for the residence nil rate band (RNRB) before any inheritance tax is due.

The current band of £175,000 is scheduled to apply without increase until at least the end of the 2027–28 tax year.

How to apply the RNRB

Step 1: Add the RNRB to the basic IHT threshold if the person and their estate meet the qualifying conditions. This higher threshold does not mean that the home is exempt from IHT but that can be the effective outcome in some cases.

Step 2: Add any transferred RNRB that may be available from a late husband, wife or civil partner's estate to the amount of the RNRB due for an estate to get a combined RNRB.

Step 3: Take off the combined RNRB from the value of the estate.

Step 4: Take off the basic IHT threshold (and any transferred basic threshold) from the rest of the value of the estate. If applied before the basic IHT threshold, the RNRB can sometimes, but not always, affect the amount of any unused additional or basic IHT threshold available to transfer to a spouse or civil partner's estate on second death.

Example

A married man dies in the tax year 2025–26 and leaves to his children:

- a home worth £300,000
- other assets worth £190,000, and
- the maximum available RNRB in the tax year 2025–26 is £175,000.

RNRB for the estate	£175,000 (the lower of £300,000 and £175,000)
Basic IHT threshold	£325,000
Estate value	£490,000
Less RNRB	£175,000
Remaining value	£315,000
*Less basic IHT threshold	£315,000
Amount that IHT is due on	£0

*The full RNRB has been used up, but the unused £10,000 out of the basic IHT threshold of £325,000 would be available to transfer to the man's wife's estate on second death.

We have assumed here that the property is held in the owner's sole name. Were it to be held in joint names on a joint tenancy basis, then ownership would automatically pass to the wife on death. This would result in the main residence nil-rate band (NRB) being unused.

4.5 Calculating Cash Flow at Key Life Stages

- **Cash flow forecasting** – being in control of cash flow is key to financial security and eventual financial independence. Most people have predictable amounts of cash coming in and going out each month, particularly if they are salaried employees. Irregular payments can cause problems but even these are not generally unexpected – home or car insurance premiums paid for annually can be factored in. While it is important to determine the current cash flow situation, events can have a dramatic impact upon the financial plan; it is important to consider how these can impact on the financial planning advice. Cash flow forecasting helps anticipate shortfalls in income and capital allowing clients to prepare and plan, ensuring they have sufficient liquid assets to cater for unexpected occurrences.
- **Marriage** – marriage or a civil partnership will usually affect a client's financial position and future needs. The ceremony in itself may be a major financial commitment and could require loans in order to pay for it, depending on the financial circumstances of the couple. Once married, it may be that two incomes can be taken into account, assets can be transferred between them with no immediate CGT liability, and life insurance may become a priority to protect the survivor in the event of death; this might also include changing the beneficiary on any death in service benefits and employer pension plans. All the possible changes that occur once two people are married or become civil partners have an impact on current and future financial needs.
- **Children** – in terms of financial and personal protection needs, the birth of a child can mean:
  - potential loss of income (either temporarily or more long term)
  - the cost of childcare
  - the cost of future education
  - a house move
  - tax credits, or
  - an increased need for life cover.

  There are a number of insurance options to deal with some of the issues raised above:
  - **life insurance to provide a lump sum** – written in trust to provide childcare or payment of school fees
  - **critical illness cover** – to provide a lump sum to pay for school fees, and
  - **income protection** – to pay childcare or school fees in the event of illness or accident.

  Plans can be in the form of:
  - monthly savings into a tax-efficient offset mortgage account
  - savings into tax-free savings ISAs
  - changing existing plans to meet school fees schedule
  - planning to cover any increases in fees
  - university fee plans, or
  - converting endowment mortgage plans.

A bespoke school/university fee plan should consider a variety of circumstances:

- the tax status of the client, eg, for non-taxpayers or non-UK residents, offshore investments may be suitable
- appropriate diversification of investments and assets
- the use of tax-efficient vehicles where appropriate
- taking account of children's annual CGT annual exempt amount
- appropriate use of trusts, and
- products that complement protection policies already in place.

- **Divorce** – divorce requires careful financial planning and organisation, as it involves the legal, personal and financial separation of two sets of finances that have been previously combined. Financial settlements may involve reassigning policies and assets and may involve taking on new financial liabilities. Previously held policies, assets and accounts as well as details of beneficiaries, may have to be changed, disposed of and untangled. Future plans and priorities are also likely to change, effectively requiring a completely new KYC record to be made up for each client involved.
- **Retirement** – rather than the term 'retirement', many financial planners now prefer 'financial independence', which is where the client has enough capital and other assets available for work to be optional and their desired lifestyle is affordable. This way every client has their own definition and vision of what 'financial independence' means to them. In essence, the planner seeks to get the client to describe this and then quantify what is required; this can be as simple or complex as the client wishes.

  Once the planner knows what the client needs to live on comfortably, in real terms, they can compare this with the expected state and private pension and other capital resources likely to be available at the time. A cash flow forecast can then be built, from which the planner can establish whether the client is on track or needs to allocate more resource(s) or time.
- **Disability and critical illness** – disability and/or critical illness not only impacts a client's personal options, future plans and quality of life, it can also present serious financial issues. Circumstances must be reviewed, future priorities discussed, and appropriate financial planning put in place. From the adviser's point of view, much is dependent on the nature of the disability and future prospects for employment, care, and the assets of the client. The client may rely on health and/or income protection policies to cover financial burdens for a period of time; however, these do not provide for the long term, and other options will require investigation.
- **Death** – the impact of death differs from all the other significant events in that it is final and, if financial planning is not put in place to cater for this event, any dependant can suffer from the lack of planning. On the other hand, the client may be the beneficiary, resulting in their circumstances radically changing. In this scenario, present and future priorities may alter and their own IHT, retirement and protection plans could be affected. There may also be an IHT bill to pay. All of these aspects require a range of financial planning options to be reviewed.
- **Time value of money** – financial planners are likely to carry out several different calculations when preparing a client's financial plan. While financial planning and cash flow software packages and spreadsheets may be used, it can sometimes be quicker to use a calculator; where compound interest calculations are required, it is generally easier to use a scientific or financial calculator.

Time value of money calculations can help to calculate:

- how much an investment will be worth after a certain period of time
- how much needs to be saved each month or each year to reach a target capital amount in the future
- the effective rate of return investments would need to achieve to ensure that a target capital amount is attained in the future, and
- how long it will take before an initial investment grows to a target amount.

For example, if a client's objective is to save for their children's university education, and they know how much money they will need in the future and how many years this will be needed for, then a calculation can be carried out to see how much they need to save per month now, based on an assumed rate of return. By identifying this amount, a plan can be put in place to ensure the client's objective can be achieved.

Compound Interest

To calculate the future value of a lump sum, the formula needed is:

$$FV = PV \times (1+r)^n$$

This is the basic formula for compound interest, where:
PV = present value – the current value of the asset
n = the number of time periods – normally expressed as years or months
r = rate of interest – converted to a decimal, eg, 4% = 0.04
FV = future value – the future value of the asset

Example

Aaron has £15,000 in an individual savings account (ISA) which he has earmarked for his daughter. She is three years old but he would like to provide £30,000 for her in real terms, (after inflation) when she is 25. The rate of return has been estimated after inflation, to average 2.5% pa. Aaron wants to know if the current £15,000 is enough to provide the £30,000 he would like.

PV = £15,000
R = 2.5% converted to a decimal = 0.025
n =22

The future value (FV) is: £25,823.57 = £15,000 x $(1.025)^{22}$, which is not enough to meet Aaron's objective.

Let us now turn this around and imagine that the goal is to have a certain lump sum in the future. The question now is how much should we start with: what is the present value to achieve the future value? This is also known as 'discounting'.

We know that multiplying the present value by (1 + r) to the power of n gives us the future value. So to find out the present value we do the opposite and divide. The formula we need to work out present value is:

$PV = FV/(1 + r)^n$

Using the example of Aaron's goal above, he asks for an estimate of how much capital he needs to allocate now to achieve the objective, using the same data. This requires some manipulation of the data, but the result is easy to calculate.

FV = £30,000
r = 2.5% converted to a decimal = 0.025
n = 22
The present value is £30,000 / $(1.025)^{22}$ = £17,425.94, which is £2,425.94 more than he has currently allocated.

5. Establishing Priorities and Objectives

Learning Objective

1.6.1 Be able to evaluate and respond to the main drivers underpinning the client's financial needs, and objectives and aspirations, by prioritising them in collaboration with the client: identify differing client needs, realistic financial objectives and associated timescales; prioritise present and future needs; agree investment objectives, growth, income, time horizons; net disposable income

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We have already established how important it is to build a detailed picture of a client's personal and financial circumstances, their current and future needs and their aims and objectives.

It is up to the financial planner to recognise what the client's needs and objectives are, and to make a distinction between those that are more immediate and those that are more long term.

For some clients, the most immediate need might be to pay off credit card debt or reduce overdraft facilities, with a more long-term objective of achieving financial independence, for example, by the age 60.

When setting client objectives, SMART is a useful acronym to use. The objectives need to be the following:

- **S**pecific – so the client knows exactly what it is they are aiming to achieve.
- **M**easurable – in other words, it is possible to tell when it has been achieved.
- **A**chievable – if it is achievable, it is more likely to happen.
- **R**ealistic – does the client have the money to achieve the objective?
- **T**ime-related – there needs to be a deadline to work towards.

Clients may have more goals and objectives than their current finances permit; it is vital, therefore, to be able to establish how important they are to the client and bearing in mind their affordability, to help them prioritise. A client's perception of need may be very different from reality, and it is essential that the financial planner anticipates how these needs might change in the future and build a degree of flexibility into the financial planning process. Their net disposable income will need to be considered as an important part of this, ie, how much spare money they have to put towards achieving their financial goals once essential monthly expenditure is met.

To identify and respond to the main drivers underpinning the client's financial needs and objectives, a process should be undertaken which helps the client to carefully think through their current situation to identify, discuss, quantify and prioritise needs and objectives.

The biggest priorities should be tackled first; these are identified by considering needs in order of their relative importance. Priorities will differ according to a client's circumstances; a younger person with a young family might want to start with perhaps reducing the level of credit card debt, build up short term savings and protect their dependants in the event of illness or death. Older clients will normally have very different priorities such as estate planning, helping with grandchildren's university costs, and long-term care.

A client may well have thought through what they consider to be their main priority, but after discussion and financial analysis with a financial planner, they may ultimately agree that the actual priorities are very different from those originally perceived. It is important that the client agrees that they have a specific need, even if they do not want to address the need at the time or may not be able to afford to do so. In these circumstances, it is the responsibility of the financial planner to make the client aware of the relative importance of the specific need, what the implications are of not addressing this need, and any future strategies that could be used when the client is ready to proceed.

Traditionally, investors have tended to fall into one of three categories – income, growth or income and growth. Income investors require a regular payment from their investments in order to meet their required standard of living. This can be in the form of 'natural' income, ie, the regular interest paid on their fixed-interest holdings and the dividends paid on their equities. Alternatively, where this will not suffice, an 'income' stream can be created in the form of regular capital withdrawals, albeit this is a course of action which risks depleting the fund value if not monitored regularly.

Growth investors are those who do not require access to the portfolio or its returns in order to meet their essential or lifestyle expenditure. Their objective is simply to grow the value of their wealth. Investors at the more cautious end of the spectrum may simply wish to maintain its value relative to inflation and may be content with a high fixed interest/low equity model. More aggressive investors with a higher capacity for loss may have higher returns in mind and may be happy with an adventurous or speculative approach. As a general rule, the longer the investor's time horizon before needing the money, the higher the degree of risk which is able to be taken.

Income and growth investors look to strike a balance between the two. Whilst the level of income required and desired growth rate may vary depending on individual needs, there will always be some element of trade-off. Ultimately, an income and growth investor is looking to at least maintain the value of their portfolio whilst also taking regular payments from it.

An essential part of investment planning is to assess the client's overall risk profile. This consists mainly of their attitude to risk and their capacity for loss.

Attitude to risk determines what level of risk the client is comfortable taking with their capital in pursuit of income or gains. There is a direct relationship between risk and reward in terms of returns. Over the longer term, investors who are prepared to invest in higher-risk assets, such as equities, tend to achieve better returns. However, these are also significantly more volatile and investors need to be prepared to see significant fluctuations over the short term.

A planner needs to be aware, however, that all the risk tolerance in the world may not be appropriate if the client does not have capacity for loss. Put simply, a client should not risk more than they could afford to lose. Assessing capacity for loss requires an objective assessment of how much the client could afford to lose before it would materially impact their standard of living.

Example

Frank is aged 65, divorced and has just retired after a long career spent working in the oil industry. He has an unencumbered property valued at £1,000,000 and a defined benefit pension of £100,000 per annum, having retired as a director. He also has £200,000 cash savings and a stocks and shares ISA valued at £500,000, invested in funds with a cautious risk profile.

Derek has also just retired from his job in the telecommunications industry at aged 60, having taken early retirement. He has a modest £200,000 semi-detached home and cash savings of £20,000, however, still has an outstanding mortgage of £50,000. His retirement provision consists of his defined contribution pension, valued at £400,000, which is invested primarily in global large and small cap equities plus, eventually, his state pension.

In this example, Frank would appear to have the capacity to take more risk should he wish to. Given his overall wealth and lifetime pension income, he is unlikely to be impacted by investment losses, particularly short-term ones. Derek, on the other hand, clearly has limited retirement provision. While he could repay his mortgage with his pension commencement lump sum, he should consider taking a more defensive approach, particularly until his state pension comes into payment.

The FCA has broken expenditure down into three categories: essential cost of living, lifestyle and discretionary. The goal of a financial planner is to ensure that clients have sufficient funds to meet essential and lifestyle expenditure. The extent to which this is the case is a key factor in determining the appropriate level of risk to take. As a general rule, those who have a positive net disposable income (ie, surplus income after meeting expenses) are likely to be growth investors and can usually afford to take a greater degree of risk with their investments.

In the example above, Frank and Derek's financial planners would need to work closely with them to ascertain their likely expenditure and how much of it falls into each category. All things being equal, Frank would be expected to have much more scope for discretionary expenditure than Derek. However, once this has been done, the planner can establish how much each could potentially afford to lose.

6. Analysing Existing Financial Arrangements

Learning Objective

1.7.1 Be able to analyse gaps in a client's current financial provision and how the client's financial provision could be improved according to agreed priorities: immediate liquidity; ongoing income and expenditure; protection; retirement provision; attitude to risk and growth/ investment return assumptions; ethical values/environmental, social and corporate governance (ESG) requirements

1.7.2 Be able to evaluate the performance and suitability of the client's existing investments taking into account the client's current financial provision

1.7.3 Be able to evaluate the performance and suitability of the client's existing investments taking into account the client's objectives

1.7.4 Be able to evaluate the performance and suitability of the client's existing investments taking into account the client's: risk appetite; risk required; capacity for loss

1.7.5 Be able to evaluate the performance and suitability of the client's existing investments taking into account the client's current and future tax status

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A key part of financial planning is assessing a client's existing assets and other arrangements that they have in place. If they already have death in service cover for example, or savings plans, then this must be taken into account when considering recommendations.

It would usually be the case that existing life cover should be kept unless the adviser can clearly show that the product is unsuitable, or that they can provide cover at a lower cost. The adviser should always be mindful that any decision must be in the client's best interests.

The importance of regular financial reviews has been stressed already, so that an adviser can keep up with a client's changing circumstances and can ensure that products continue to meet the client's needs, as well as to monitor investment performance.

We have already considered that, by its very nature, a financial plan evolves and develops over time through an ongoing relationship with the client and, when the budget to fund financial solutions is scarce, priorities must be agreed upon. The adviser's recommendations should be based around ways in which the client's finances can be best utilised, and should take into consideration the client's assets, investments, liabilities and income. Just as analysing the way in which the client spends their funds is a vital aspect of the financial planning analysis, including a review of their expenditure in both the short term and the long term will also aid in demonstrating just how robust the overall financial plan is.

The best financial plans ensure that clients have sufficient liquidity for expenditure requirements and for unexpected emergencies, that protection is in place in case of death, critical illness or the inability to work while ensuring that investments are aligned to clients' attitude to risk, and are suitable for the client's objectives, be that income, growth or a combination of both.

At the analysis stage, a financial planner should be able to identify any weaknesses in the client's current financial situation and recommend ways that it could be improved upon. Gap analysis enables the adviser to identify any shortfalls in:

- protection cover
- emergency funds
- longer-term savings plans for children's education or marriage, for example
- retirement and long-term care planning.

The risks associated with maintaining a client's financial security mean careful consideration of the financial implications of any of the following events happening:

- death
- accident and/or illness
- redundancy
- unemployment
- divorce.

The way in which these types of risks can be managed is by making adequate provision should the worst happen. Life insurance can be taken out to cover the risk of death occurring, while family expenditure is high, whereas short periods of unemployment can be best managed by ensuring that there is an adequate emergency fund held in liquid assets.

The important aspects to identify are:

- the number of dependants
- the amount of capital needed in the event of death/illness
- the amount of income needed in the event of death/illness
- the term that cover is needed for
- any liabilities, eg, mortgage and credit card debt, and
- the effect a death will have on expenditure.

When analysing gaps in a client's financial planning, account must be taken of their objectives and priorities and whether they have the means to meet all of their objectives.

For a client in the accumulation of wealth stage of their working life, their priorities are likely to be loosely as follows:

- **Emergency funds** – ensuring that the client has some financial resources to fall back on in the event of unexpected expenditure.
- **Protection** – cover for unexpected significant events such as death, serious illness or inability to work.
- **Retirement planning** – saving tax efficiently so that they can meet their expenditure when they are no longer working.
- **Saving** – building up accessible savings beyond the basic emergency fund.
- **Investment** – outside of the pension arrangement, such as stocks and shares ISAs or general investment accounts. Generally considered when the client has significant funds and no foreseeable short-term need for them.

Example

Anton and Elissa are considering their protection needs. They feel that should either of them die or become unable to work due to illness or accident, the other will need around £25,000 pa to cover their needs. They have twin daughters, aged 5, who they assume will be dependent on them for a minimum of 13 more years. They currently have the following in place:

- Death in service cover with Anton's employer of £200,000. If Anton were to die, this sum of money would need to be invested and is unlikely to provide the sum Elissa would need. The cover also depends on Anton staying with his current employer.
- Elissa has a ten-year term insurance policy with a sum insured of £150,000. The term is too short for their needs and the sum insured not sufficient to provide the income needed.

The position could be improved by:

- putting in place extra life cover for both Anton and Elissa, taking into account the required term and sum insured
- considering income protection to provide an income to cover themselves in the event that either of them could not work due to illness, or
- considering critical illness to provide a lump sum in the event of either of them contracting a serious illness.

Both Anton and Elissa have a gap in the income they need and the income that their current provision would provide.

The provisions they make for their financial security will need to be prioritised depending on their available budget.

Financial planning recommendations involve a number of key assumptions which impact financial planning, including:

- investment returns
- future inflation, and
- earnings growth.

A plan based on a client's income and expenditure will necessitate an assumption on growth rates for future price inflation and future earnings growth. Of course, it is entirely feasible to try out a number of different assumptions, and build in differing growth and inflation rates for different periods in the client's life, eg, if they plan a career break at a certain age or decide on early retirement – but, in the end, a plan has to be agreed based on one set of assumptions at a time. Again, this point emphasises the huge importance of regular reviews, partly to test and adjust assumptions as economic and personal factors change.

Assumed growth rates for investment returns may be based on a number of factors, but should reflect the client's risk profile. For a client who is very risk averse, an appropriate portfolio may consist mainly of fixed interest such as gilts or investment grade corporate bonds, with a small weighting in blue chip equities. This sort of portfolio is likely to provide steady and less volatility, but ultimately unspectacular returns.

For a more adventurous client, who is happy to have a larger percentage in equities and to invest in growth companies at an early stage as opposed to more mature ones, a higher assumption for investment returns over the long-term would be likely to be appropriate. Prevailing economic circumstances may also need to be taken into account in the short-term, for example whether the advice firm and the market as a whole exhibit a bullish or more bearish view.

6.1 Risk Appetite, Risk Required and Capacity for Loss

Even if a client has the time, inclination and knowledge to assess the performance of their investments, most do not have the same access to industry knowledge and data comparisons that an adviser does. Furthermore, investment markets, indices and funds change quickly in response to a variety of economic, regulatory, internal and legal changes, and new products may appear in the marketplace that may be better suited to a client's risk profile, tax status and other financial provision. It is part of the role of a financial planner to be aware of such matters and to ensure that the client benefits from the financial planner's continuously updated knowledge.

The key to making suitable recommendations is accurately assessing the client's risk profile. Risk raises the possibility that the client may lose some or all of their investment, or that the growth rates that have been assumed do not materialise. Accurately assessing a client's risk profile, including capacity for loss are arguably the biggest issues when considering wealth management options. The consequences of not understanding attitudes to investment risk, and the inherent risk within different types of investment, can be severe.

In addition to an assessment, it is vital to encourage clients to spend some time considering their own thoughts and feelings regarding investment risk. Risk profiling is, by definition, an ongoing process and a person's attitude to risk can change over time. This could be influenced by any one of a diverse range of factors, such as personality, past investment experience, job security, proximity to retirement, asset values, family or health issues. It is, therefore, vitally important for an adviser to keep up to date with any changes in a client's outlook to investment risk as this allows a reassessment of how the client's investments are managed within different asset classes.

Equally key to providing an appropriate financial planning service is to appropriately evaluate risk required, ie, how much risk does the client need to take to achieve their objectives. As we have seen, there is a relationship between risk and reward, over the long-term, the more risk a client is prepared to take with their capital, the greater the ultimate rewards are likely to be. However, the trade-off for this is that the client needs to be prepared to experience greater potential volatility in the short-term.

Example

Saeed is looking to send his son Ali to private high school in two years' time at a cost of £15,000 per annum. This is expected to increase by 4% per annum. Ali is expected to attend for seven years before starting university. Saeed has a lump sum of £100,000 designated to pay for Ali's education

Saeed requires an annual rate of return of c 3.39% (to two decimal places) in order to be able to pay the school fees as set out in the table below:

	Starting value	School fees	Value after fees	Returns	End value
Year 1	£100,000	£0	£100,000	3.39%	£103,386.53
Year 2	£103,386.53	£0	£103,387	3.39%	£106,887.74
Year 3	£106,887.74	£15,000	£91,888	3.39%	£94,999.54
Year 4	£94,999.54	£15,600.00	£79,400	3.39%	£82,088.43
Year 5	£82,088.43	£16,224.00	£65,864	3.39%	£68,094.95
Year 6	£68,094.95	£16,872.96	£51,222	3.39%	£52,956.63
Year 7	£52,956.63	£17,547.88	£35,409	3.39%	£36,607.88
Year 8	£36,607.88	£18,249.79	£18,358	3.39%	£18,979.79
Year 9	£18,979.79	£18,979.79	£0	3.39%	£0.00

In this example, Saeed's need to take risk would appear to be very limited. The level of returns he requires could in all likelihood be achieved using a series of deposit based fixed rate bonds, or a very low-risk investment fund including gilts and investment grade corporate bonds.

6.2 Tax Status

Financial planning clients in general will be subject to a number of taxes during their lifetime. These can vary in nature and extent and can include anything from value added tax (VAT) paid on everyday purchases to stamp duty paid on the purchase of a property.

Many clients, especially high net worth ones, will have their own specialist professional tax advisers to advise them on how to structure their affairs in the most tax efficient manner whilst ensuring the remain compliant with legislation. It is, however, imperative for a financial planner to have a good working knowledge of the main taxes which impact a private client based in the UK.

This is particularly the case where the planner is aware that a piece of tax legislation, or a client's status in relation to it, may be subject to change.

The most common taxes that a financial planner will have to deal with and advise on are as follows:

- **Income tax** – this is paid on income earned, such as salary from employment or a business which is in excess of the personal allowance. It is also paid on interest earned from deposit-based savings accounts and on dividends from shareholdings, which are subject to their own smaller exempt allowances. Income tax may be deducted at source by an employer, or accounted for by means of a tax return or adjustment to a tax code.
- **National insurance** – again, national insurance is paid on employment income. Employee contributions are deducted at source by the employer, which is also responsible for making its own employer contributions. The self-employed will account for their own national insurance, which is taxed at different rates. National insurance is not payable on dividend or savings income and nor is it charged on employer pension contributions.
- **Capital gains tax** – paid on the disposal of non-exempt assets, capital gains tax is subject to its own annual exemption, which is £3,000 for the 2024–25 tax year. Gains in excess of this are charged at 10% for basic rate taxpayers or 20% for higher rate taxpayers, other than certain assets such as second properties which are charged at 18% or 28%.
- **Inheritance tax (IHT)** – levied on those with estates in excess of the nil rate band, which is currently £325,000 per person with an additional main residence nil rate band of up to £175,000 which can be set against owned residential property. Transfers between legally married spouses do not attract IHT, whatever their value and each nil rate band can be transferred between spouses if not used on first death, meaning a married couple have a total potential nil rate band of up to £1 million. The main rate of IHT on estates above the nil rate band is 40%. IHT is covered in more detail in chapter 2.
- **Annual allowance** – this limits the amount of tax relievable contributions that an individual can make into a defined contribution scheme and their benefit accrual within a defined benefit scheme. Loosely, total pension input in any one year is limited to £60,000 per individual, plus potential carry forward where applicable. A tax charge will be incurred in respect of any accrual which exceeds the limit. Lower limits may apply in certain circumstances, mainly for very high earners or those who have already flexibly accessed benefits.

Pensions and retirement planning, including the applicable taxes, are discussed in more detail in chapter 3.

It is important when providing advice to keep the client's tax position under review. Any changes that occur in either the client's personal circumstances or the external environment, such as tax rates, allowances and legislation could impact the appropriateness of their financial plan. It is important that advisers are proactive in planning for tax efficiency.

Example

Jacob is a marketing manager earning a salary of £50,000 per annum. He currently makes 10% matched contributions to his employer's occupational defined contribution pension scheme on the relief-at source basis.

He also has a stocks and shares ISA valued at £46,000 invested in a worldwide equity growth fund and a general account valued at £100,000 invested in the same fund. The book cost of the general account funds was £75,000 and each year, Jacob uses the bed & ISA facility to move £20,000 of this to his tax efficient ISA, which he has done for the current tax year. Jacob does not wish to pay any higher rate income tax and nor does he wish to pay capital gains tax.

On 1 April 2024, Jacob receives a promotion to Head of Marketing and a pay rise to £65,000. A few weeks later, Jacob has his annual meeting with his financial planner.

Firstly, following Jacob's pay rise, his annual income net of his pension contributions will be £58,500. As a result of the pay rise and the frozen income tax bands, as it stands, Jacob is going to have to pay higher rate income tax, given that his income now exceeds the £50,270 higher rate threshold. Jacob is therefore either going to have to accept the higher rate income tax charge, or take measures to mitigate it, such as increasing his pension contributions.

Secondly, his general account has capital gains which currently stand at £5,000 out of each £20,000 of its value. This means that if he continues to bed and ISA the funds, he will crystallise gains of £5,000 for each full tranche of £20,000 that he moves into the ISA. This means he will pay capital gains tax.

Therefore, if he is still insistent on not doing so, he will have to reduce the amount transferred using the bed & ISA process, meaning either not utilising his ISA allowance in full, or he will need to make up the balance using cash savings. If Jacob is married, he can also consider transferring some of his holdings to his spouse to bed & ISA in her own name, since there is no capital gains tax payable on transfers between spouses. However, he would then lose ownership of the assets.

Jacob's adviser should be pointing both of these issues out to him at his annual review.

If a client's tax status is likely to change in the foreseeable future, this could have an impact. For example, if a client is likely to become a basic rate taxpayer in the near future, this could be the time to encash investments, such as investment bonds, that would be subject to the basic rate of tax rather than the higher rate. It could also highlight the opportunity to make pension contributions now when someone is a higher rate taxpayer, and have pension income at retirement taxed at basic rate.

Other planning opportunities include the following:

- Transferring assets between spouses where one is a higher rate taxpayer and the other is a basic rate taxpayer. This can have benefits for both income tax and CGT.
- Utilising the marriage allowance where appropriate.
- Utilising tax-free investments, such as ISAs and national savings products.
- Arranging affairs appropriately if the High Income Child Benefit Charge (HICBC) is an issue. The HICBC charge only applies when the income of the child benefit claimant or their partner is above £60,000, and is only worthwhile if adjusted net income of one partner is less than £60,000. This means the claimant can elect not to receive child benefit so that the HICBC will no longer apply.

The circumstances need to be very specific to use the marriage allowance. It is available to basic rate taxpayers, who have a spouse who is a non-taxpayer. It allows the spouse to transfer unused personal allowance of up to £1,260 for the taxpayer to use in addition to their own. This can, therefore, result in a tax saving of up to £252.

Example

Ella, aged 68, is widowed following the death of her husband Bill ten years ago. Ella inherited Bill's full nil rate band for inheritance tax purposes following his death. She has a new partner, Phil aged 65, who is divorced from his previous wife. Both Ella and Phil had successful careers and estates valued at over £1 million including unencumbered properties and numerous investments.

Ella and Bill never had children, however, Phil has two, Joe and Jess, from his first marriage. Ella has a good relationship with Joe and Jess and would like them to benefit from her estate following her death. They are also Phil's beneficiaries.

Earlier this year, Phil and Ella decided that they were to marry. Following the marriage, they intend to rewrite their wills to leave their assets to each other, with a stipulation that should the other predecease them then the assets will go to Joe and Jess. A couple of months later, they have an annual review meeting with their financial planner.

The planner informs them that they should reconsider the way they wish to write the wills. This is because Ella has inherited one nil rate band from Bill and therefore cannot inherit another. Nor can Phil inherit both nil rate bands from her. It is not possible to inherit more than one nil rate band. Therefore, it would be more tax efficient for both to leave at least the first £325,000 of their estate directly to Joe and Jess in the event that they predecease the other. This would mean that all three nil rate bands could be used instead of just two.

6.3 Performance

One key part of the regular review process is reviewing the performance of the client's existing investments. The planner needs to consider whether and how they have met the client's objectives and whether the product remains appropriate for those objectives.

For growth investments, this tends to be more straightforward. The level of growth in the fund, be that over the review period, relatively short term or longer term, is a matter of fact which can be objectively quantified. Low-risk investors, whose goal is only to keep pace with inflation, are likely to be satisfied with a fund which has done so. More speculative investors, who are looking for their money to work harder, are likely to be harder to please.

An element of fund performance may be down to market movements. In simple terms, if the stock market in general has suffered a crash due to events beyond the control of the fund manager, then an investment fund is also likely to have fallen in value, known as systematic risk.

6.4 Benchmarking

In order to ensure information is meaningful, it is standard practice to compare performance to a benchmark. This is a model portfolio run by associations such as the Wealth Management Association (WMA) which provide an indicator of the expected average performance of funds with certain degrees of risk.

While the benchmarks are never likely to exactly replicate the risk level of any individual fund, they can assist in identifying significant underperformance or outperformance. An investment fund will usually set an objective in terms of performance against a selected benchmark. It is important to note that what constitutes an appropriate benchmark is, by nature, subjective and the fund manager's view of the appropriate benchmark may not always match that of the planner.

Where a fund has outperformed a similar one, it may be an indication of the stock picking skills of the fund manager, or a reflection of the manager taking an increased degree of risk. There are a number of investment calculations, including the Sharpe ratio, Treynor ratio and information ratio, which are designed to calculate the risk-adjusted return produced by a holding or portfolio. A detailed examination of these concepts is beyond the scope of this study text.

For income investors, or income and growth investors, the planner needs to consider whether the income need is being met and whether this is being met from the natural income of the portfolio or by drawing down on capital. The latter is perfectly acceptable as a strategy but may result in capital depletion if withdrawals exceed sustainable rates. It may prove necessary for an adviser to consider alternatives which provide a higher level of 'natural' income.

Where a holding has consistently underperformed other similar funds over a number of years, a planner may recommend the replacement of the holding. This should only be done after a detailed examination of the reasons for the discrepancy. Historically, the financial planning industry in the UK had a significant problem with 'churning', the practice of an adviser recommending the replacement of an existing holding with weak justification in order to generate commission payments. This was part of the reason for this remuneration method being banned from January 2013 as part of the Retail Distribution Review (RDR).

Advisers also need to consider the ongoing appropriateness of even well-performing products in light of the client's objectives. For example, if the client has significantly brought forward their retirement date, it may be appropriate to seek to reduce the overall risk level of their portfolio to reduce the risk of a significant crash damaging their retirement plans.

Example

Nathan has earnings of £15,000 and his wife Gina has earnings of £4,000. As Gina is not utilising all of her personal allowance she can elect to transfer 10% of it to Nathan; this is only possible because Nathan is a basic rate taxpayer. In the 2025–26 tax year, the transfer equates to £1,257 and saves Nathan £252 in income tax. If the allowance has not been claimed since its introduction in 2015, it can be backdated by making an online application.

Example

Kim has two children; her entitlement to child benefit is, therefore, £2,515.60. Her earnings in 2025–26 are £62,000. The tax charge will be: £2,000/100 = 20(%), so the charge will be £2,515.60 x 20% = £450.32. To avoid the charge, Kim could make a pension contribution to reduce her adjusted net income to £60,000. This will result in her keeping all of the child benefit while at the same time increasing her pension savings and benefiting from 20% tax relief at source, as well as higher rate relief on the pension contribution.

The 2025–26 rates are £26.05 per week for one child and £17.25 per week for any further children.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **What are the steps of the financial planning process?**
   Answer reference: Section 1.1.1

2. **Name five pieces of fact-find information essential to create a financial plan.**
   Answer reference: Section 2.1

3. **Give two examples of 'soft facts' and two examples of 'hard facts'.**
   Answer reference: Section 2.1

4. **Define 'capacity for loss'.**
   Answer reference: Section 2.2

5. **Which ethical fund applies the strictest ethical criteria: light green, medium green or a dark green fund?**
   Answer reference: Section 2.4.1

6. **What is an 'execution-only' service?**
   Answer reference: Section 3.1

7. **What service does the Money & Pension Service (MaPS) provide?**
   Answer reference: Section 3.1

8. **Why is it important to establish a client's income and expenditure?**
   Answer reference: Section 4.3

9. **What can time value of money calculations help with?**
   Answer reference: Section 4.5

10. **What does the acronym SMART mean in relation to setting objectives?**
    Answer reference: Section 5

Chapter Two

Financial Protection

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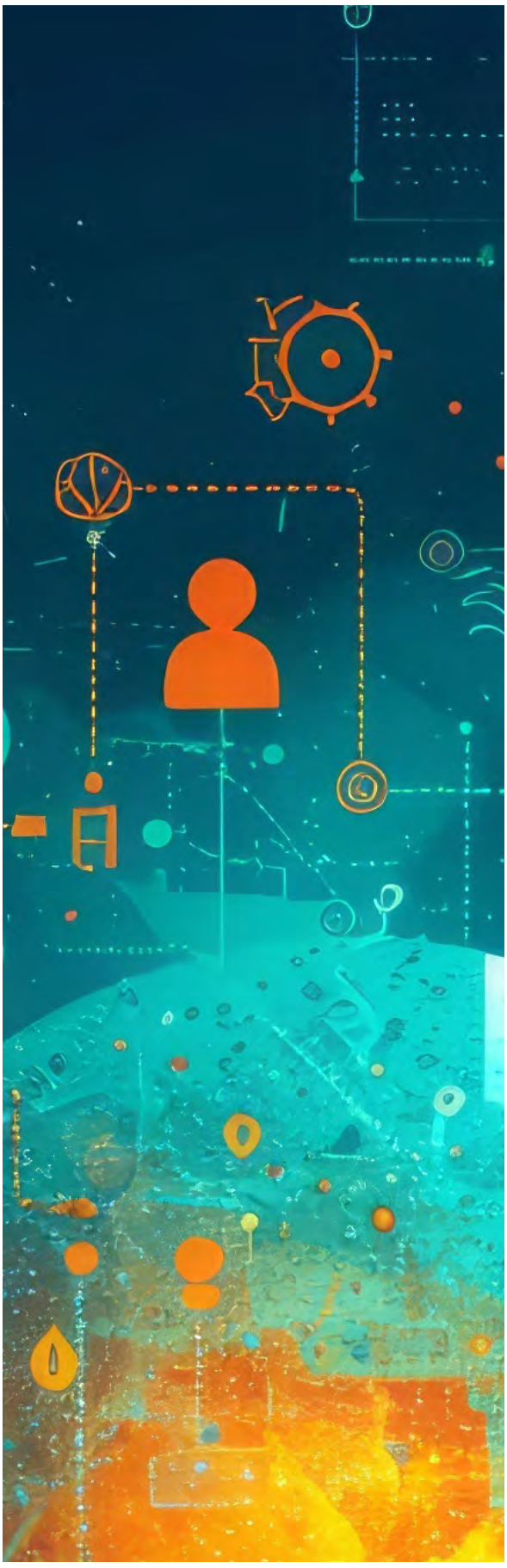
This syllabus area will provide approximately 19 of the 80 examination questions



1. Market Factors and Trends

1.1 Attitudes to Financial Protection

Learning Objective

2.1.1 Be able to analyse consumer attitudes and behaviours to protection needs planning

2.1.2 Know the factors relevant to consumer access to advice and/or insurance cover

2.1.3 Be able to interpret trends in: health and morbidity; longevity and mortality; employment

2.1.4 Be able to interpret the implications for product design and development

2.1.5 Be able to understand the intended target market defined by the product provider

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Consumer attitude to financial services has changed over the years, and the understanding of financial matters has improved over time, with the internet providing greater access to information, comparison sites and simple products. However, it is still the case that people remain underinsured when it comes to protecting their families in the event of death or illness. There are various possible reasons for this, including:

- **over-reliance on the state** – state support provides a minimum level of protection
- **failure to forecast and accept the possibility of adverse events** – 'it will not happen to me', and
- **affordability** – disposable income is channelled to more immediate needs, such as housing and food.

A trend has emerged recently where customers are seeking access to products and may even carry out their own research so they have a better understanding of products either before or after

seeing a financial planner. The internet has also provided easy access to simple protection products; the risk is that these are bought by consumers without full knowledge of whether they are really suitable for them, whether the provider is whole of market and will include commission within the premiums.

This seems a long way off from the in-depth, fact-finding process and regular reviews that financial planners use which backs up the idea of how a streamlined approach might work for consumers. In section 3.1 of the first chapter, we touched upon the Financial Advice Market Review (FAMR), which addressed the issues of affordability, access to advice and the redress available to consumers in light of these consumer trends.

The Retail Distribution Review (RDR) was only concerned with retail investment products and so had little impact on the advice given on, and sale of, pure protection products which have no investment element. As a result, planners can still receive commission from life companies for advice given.

It is still the case that a lot of individuals who need, or could certainly benefit from advice will never receive it. There are still widely held negative perceptions of the financial services sector and individuals who do not see the benefit of paying for financial advice.

1.2 Trends

1.2.1 Health and Morbidity

In England, the burden of morbidity has been increasing, with little change to the leading causes, such as lower back pain, skin diseases and depressive disorders remaining the leading causes for both men and women.

According to research carried out by Public Health England, in 2013, and reviewed in 2017, the leading risk factors for morbidity were high body mass index and high blood sugar levels; smoking and alcohol use were also significant contributors. Although the smoking rate has declined, there has been little change in other risk factors such as being excessively overweight.

1.2.2 Longevity and Mortality

According to the Office of National Statistics (ONS), the average life expectancy of a child born in the UK, in 2019, is just under 90 years, while the number of people aged over 65 outnumbers those aged 16 and under.

This changing demographic is driving a number of changes; for example, in light of an ageing population and decreasing mortality rates, numerous final salary pension schemes have been closed by employers seeking to reduce their liabilities. There is also a demand for new products and services to meet the needs of our ageing population.

1.2.3 Employment

Changes have also taken place in the workplace with less job security and more people becoming self-employed, often through redundancy. A younger generation may be surprised to learn that their grandparents had a job for life. Nowadays, the majority of people will have several jobs and some may even have a number of different careers.

With long-term employment, employees had security not just in terms of a salary, but also in terms of other benefits such as sick pay, life cover, and a pension. The reduction of this 'safety net' means that gaining personal financial security in the event of illness and death has become important for many more people.

1.3 Product Design

To create choice, and to differentiate themselves from competitors, financial services providers have designed a range of products and services.

Arguably, these appeal more to the distribution channel than to the end customer. What the sector regards as innovation may often prove highly complex for the people to whom the products are being sold to. It is a sobering thought that many of the reviews of past sales led by regulators have had complex propositions at the root of the problem, leading to poor marketing and product literature and product misselling.

The days when investment product charges were largely concealed are now a thing of the past. In addition, following the introduction of the RDR, insurers can no longer incentivise choice through adviser remuneration structures, as investment product providers no longer pay commission to advisers.

However, while the sector has made some well-intended and genuine attempts to improve consumer understanding of its products and services, the terminology that is used can still be confusing. Perhaps there is a need for consumer education, together with the use of clearer English, when naming products.

The way consumers describe products and services provides some revealing insights. For example, when consumers are asked about income protection, many speak about the risk of being made temporarily redundant or unemployed. Only a few understand the true meaning of the term: that it relates to the risk of loss of income due to long-term incapacity. This is not surprising, given that the product name makes no reference to a long-term benefit, payment duration or incapacity. Once the concept of protecting income against the risk of incapacity on a long-term basis is understood, it is found to be valuable and useful. A consumer is unlikely to seek out a product if they are not aware that it exists, or if they lack information about its uses, advantages and disadvantages. The sector needs to be far clearer about what is, and what is not, covered.

1.4 Target Market

Under the FCA's Product Intervention and Product Governance rules, firms which are developing an insurance product must ensure that the products they design are designed to meet the needs of an identified **target market** of end clients.

Firms must take reasonable steps to ensure that the distribution strategy is compatible with the identified target market and that the product is distributed to the identified target market.

The FCA has stated that:

> *'Consideration of target market factors should permeate all aspects of product development and distribution, as well as ensuring the selection of appropriate distribution channels and the promotion of the financial instruments are accompanied by sufficient and correct information'*

Source: FCA: PROD 3.2.2

When identifying the target market, a provider must:

- specify the type or types of client for whose needs, characteristics and objectives the product is compatible, and
- identify any group or groups of client for whose needs, characteristics and objectives the product is not compatible.

When dealing through an intermediary such as a financial planner, providers are required to take steps to provide the following:

- all appropriate information on the product
- all appropriate information on the product approval process
- the identified target market of the financial instrument, including information about the target market assessment undertaken, and
- information about the appropriate channels for distribution of the financial instrument.

The provider must also ensure that the information is of an adequate standard to enable intermediaries to understand and recommend or sell the product properly.

As a financial planner advising on such products, it is crucial that sufficient steps are taken to understand the target market identified by the provider. In general, a planner should look to ensure that customers to who such products are being sold fall into those categories. Where advice is being given to purchase a product and the client is not part of the general target market, the firm should ensure that the rationale for this is robustly justified.

2. Protection Planning

Learning Objective

2.2.1 Be able to evaluate personal, family income and capital protection needs relevant to health, incapacity and accident cover

2.2.2 Be able to evaluate personal, family income and capital protection needs relevant to income, mortgage and other debt

2.2.3 Be able to evaluate personal, family income and capital protection needs relevant to death and asset protection

2.2.4 Be able to evaluate the role of insurance in mitigating personal financial risk

2.2.5 Know the areas of business protection needs – small- and medium-sized enterprises (SMEs)

2.1 Family Protection

For most people, family protection is the number one priority. If the main earner of the family is unable to work through illness or disability, it can have a devastating effect on their family. The factors to consider are as follows:

- Is the individual employed or self-employed? If the former, does the individual have any sick pay provision from their employer? If so, how much is paid and for how long? Some employers offer full pay for six months and half pay for another six months but other employers may not be so generous.
- Does the family have savings to fall back on should the main earner become too ill to work?

Once these questions have been answered, a financial planner can evaluate how much income will be needed and over what timescale. They will do this by evaluating:

- current outgoings/expenditure
- less any savings that can be made as a result of the illness
- less any state benefit entitlement, and
- less income from any other sources, such as a spouse's income and/or savings.

Example

James, aged 40, works as a facilities manager and earns £50,000 per annum. He takes home a net income of £3,000 per month after deduction of tax, national insurance and pension contributions. His wife, Helen, works part-time at the local school, having stopped full-time work when she had their first child Cliff, who is now aged 8. They also have two younger children, Claire aged 6 and Ruth aged 3.

Their essential outgoings including mortgage, council tax, utilities, food, motoring and clothing for them and the children come to £2,800 per month, which is just less than James' income. James tends to save anything spare, while Helen's earnings are mainly used as their social and holiday fund. They had savings of £20,000, however, have recently extended their home as a result of which they now only have £5,000 remaining.

James benefits from 6 months' full employer sick pay after which time they would be reliant on statutory sick pay. James' role requires him to work onsite as opposed to remotely and motoring and parking costs come to £300 per month. James currently has life and critical illness cover, but no other personal insurance. He is keen to ensure his family are protected in the event of his long-term inability to work, however, is also keen to keep costs as low as possible. He does not wish to rely on state benefits to achieve this.

In this instance, an appropriate recommendation would be likely to be an income protection policy for £2,000–£2,500 per month with a six-month deferred period to match James' sick pay. Their expenditure of £2,800 per month could be expected to decrease by £300 if James was not working and did not have to travel. Therefore, this could be met using an income protection payment of £2,000 plus Helen's earnings from the school. However, this would allow for a bare minimum standard of living. Their savings are minimal and could not be relied upon to sustain them in the event of James' long-term incapacity.

The precise amount of cover which James' planner would recommend would depend on what is more important to him, keeping costs down at this stage or maintaining his standard of living in the event of incapacity.

2.1.1 Mortgage and Debt

Establishing the level of mortgage and other debt is important to ensure that repayments can continue to be made in the event of illness, disability or death. Non-payment of a mortgage can result in repossession of property.

Provision should be considered for:

- a monthly income to cover the repayments, as well as other needs, and
- a lump sum to pay off the outstanding debt on diagnosis of a critical illness or death.

If someone has credit card debt or other loans where they are paying high amounts of interest, it might be possible to consolidate the existing debt and loans and replace them with a new, single loan.

This does have to be approached with some caution, however, as the money still must be repaid and, although monthly outgoings could be reduced with a lower interest rate, if the new loan is to be secured on property, then the risk of non-payment is that the property could be lost.

Example

Chandra, aged 35, has recently divorced his wife, Nitu. They have no children. They sold their marital property valued at £500,000 with £250,000 equity, which they have agreed to split evenly. Unfortunately, the split was not on good terms and Chandra has also run up £15,000 in legal and associated costs, which he has paid on various credit cards with interest rates varying from 10% to 16%. As a result, Chandra has no cash savings.

Chandra has seen a new property which he very much likes the look of and has had an offer of £350,000 accepted on. As he is not a first-time buyer, Chandra will pay stamp duty at 5% and he expects this and other associated costs to come to around a further £25,000.

Whilst securing unsecured debt against a property should sometimes be treated with caution, Chandra is currently paying 10–16% on his credit cards, an amount which could be substantially reduced by borrowing to pay them off. He will also need to include his fees and has been advised that he should look to build a cash emergency fund.

With his £125,000 deposit, Chandra has been offered a £275,000 25-year repayment mortgage for £1,100. He has worked out that this would allow him to purchase the property, pay his costs, repay his debts and maintain a £10,000 emergency fund.

For Chandra, a mortgage protection policy which would cover his payments in the event of his inability to work through disability would be a very good idea. It would also be worthwhile looking at redundancy if available, though cover of this nature is currently very difficult, if not impossible, to obtain in the aftermath of the coronavirus (COVID-19) pandemic.

Chandra should also consider a decreasing critical illness policy, which could pay off his mortgage in the event of him being diagnosed with a serious medical condition. Given that he is now single with no dependants, life cover is likely to be of limited use to Chandra. However, should he take out a critical illness policy then this can often be added on with minimal additional cost. Therefore, it may be worthwhile considering in case he were to remarry and have children in the future.

2.1.2 Life Cover

When planning for life cover, possibly the most important question concerns the client's dependants. If they do not have any dependants, then they may not need life cover at all. If they do have dependants, however, it is strongly advised that they obtain cover.

Quantifying the amount of capital and income will require analysis of the client's needs, most specifically:

- the amount of lump sum needed to clear any mortgage or other outstanding loans
- the amount of lump sum needed immediately – funeral costs, professional fees, unforeseen expenses

- the amount of income that might be needed long term, and
- the amount of income that might be needed short term.

Once the amount is established, the term will need to be determined. Life cover may only be needed while children are still dependent so it could last until they are aged 18 or 21. Other policies may be connected with the mortgage in which case the term would generally match the redemption term.

If the client has any existing policies, these should be taken into account.

Example

Gianni and Anna are aged 34 and 32. They have two young children, Marco and Paula, aged five and three respectively. Both are employed and earning an income of £35,000 each, which works out at £2,200 each per month after tax, national insurance and pension contributions are deducted. They have just purchased their first property on a 25-year mortgage which works out at £1,500 per month, which they split between them. The property is valued at £400,000 and the mortgage £350,000 on a repayment basis.

Their life cover needs could be dealt with in a few different ways. They could consider taking a joint life, first-death life and critical illness plan for £350,000. Or they could look at two individual plans for £175,000 apiece. If cost was an issue, then they could consider the alternative of a joint life, first death plan for half of the mortgage, ie, £175,000. However, this may leave a shortfall in the event of both of their passing.

Note that the above approach would still leave them needing to provide for the children, at least until the age of adulthood. An alternative approach would be to take out two, family income benefit policies for £2,200 a month apiece. Rather than repay the mortgage as a lump sum, this would provide a steady income to repay part of it on an ongoing basis, as well as other monthly bills, in the event of either or both of their deaths. The policy could be written until the end of the term or until the children are adults depending on cost and preferences.

An alternative may be to take out a combination of the two, a lump sum life assurance plan to repay the mortgage and a family income benefit for a correspondingly lower amount to cover other expenses.

Insurance products have been in existence for more than 600 years. The principal role of insurance is to protect against the financial consequences arising from the insured event occurring – eg, theft or fire. In the case of life insurance, this means ensuring financial security for dependants on the death of the life insured by providing a lump sum, a regular income, or both. It is designed to meet several aims, including:

- paying expenses (for example, funeral and legal costs)
- paying off outstanding debts (for example, a mortgage or other loans), and
- providing income to maintain a dependant's lifestyle.

Life cover, set up to be paid into trust, is also used in estate planning to ensure that the beneficiaries have the necessary funds to pay an inheritance tax (IHT) liability.

It is also often used to ensure that a business can survive the death of someone who may be key to its success, or that a share in a business that was owned by the deceased can stay within the control of the right people.

2.2 Business Protection

Business protection uses the same protection products that are used for **individual protection** purposes. However, they are taken out by the business or its owners or directors to cover the lives of persons associated with it.

Generally, where a policy is being taken out on the life of one person by another individual then the party taking out the cover must be able to demonstrate insurable interest. In basic terms, that party must be able to demonstrate that they would suffer a financial loss in the event of the death of the insured person. For example, a creditor may have an insurable interest in the life of a debtor, up to the amount of the debt owed, or a family may suffer a financial loss if a spouse or parent passes away.

The principle of insurable interest also extends to business entities. Specifically, a business, whether it be a sole trader, partnership or corporate entity, is entitled to take out protection on any party where the financial position of the business or its owners is likely to be detrimentally impacted as a result of the incapacity or death of that party.

Premiums depend on the amount of cover required and the ages, occupations and medical histories of the individuals being covered.

Business protection products tend to be flexible. Insurers will normally allow life insurance payments to be made in instalments to aid cash flow and to avoid corporation tax liabilities. Most will also allow risks to be placed on cover immediately, before the completion of the underwriting process. This can be especially useful in a management buyout situation if, negotiations are kept secret until the very last minute but cover is required instantly.

There are two main categories of business protection; key person cover and, shareholder and partnership protection.

2.2.1 Key Person Cover

This provides financial protection to a business in the event of a key employee dying or becoming too ill to work.

The cover, which pays out for typically up to five years, is written on the life of the key person but the premiums are paid by the employer, and any money that becomes due in the event of a claim is payable to the business, and not the key person. Who is key to a business very much depends on the type of business.

Examples can include:

- a top salesperson
- the chief designer

- the head of IT, or
- the finance director.

The costs to a business of losing a key person could be substantial and could even threaten its survival, so key person cover is intended to pay for any resulting loss of profits, as well as the costs of finding and training a suitable replacement. The cover should ideally include critical illness cover (CIC), as well as life insurance. It may also include income protection; this can provide added security, as income protection will pay out for conditions such as stress and bad backs that are not covered by CIC, however, this addition will significantly increase the costs.

This can be arranged in different ways, to provide a:

- regular income if the key person is unable to work because of an illness or injury, or
- lump sum if they die or are diagnosed with a critical illness.

The income option may be of use, for example, if the key person is a highly skilled worker and the business would need to source a replacement on a short-term basis (for which a cost premium is usually payable) in order to replace them.

The lump sum option is typically more difficult to quantify. In some circumstances, the business may opt simply for a level of cover which is sufficient to pay the worker's salary for any period of absence. In the event of death or illness which means they cannot return to work, the business may need to consider the overall financial impact.

Example

Top Class Textiles Ltd is a manufacturing business supplying cushions, curtains and other household fabric products to boutique retailers across the UK.

Monique is appointed as Top Class Textiles ltd's new sales manager, tasked with promoting the products to potential retailers. She is well connected, having worked for a number of similar retailers previously and proves very successful in growing its sales revenue to the tune of around 10% per annum. The owners are happy with this and have plans to continue this growth over future years.

Should anything happen to Monique then the expansion plans for the business could be negatively impacted and therefore it can claim insurable interest in Monique and consider taking out a key person policy on her life. The level of cover required would be, to some extent, a judgement call.

This may take into account factors such as:

- the extent to which her loss would slow growth
- any clients who are her connections and may look elsewhere for a supplier in the event of her death, and
- costs associated with recruiting and training any potential replacement.

2.2.2 Shareholder and Partnership Protection

When a firm's key person is a director or a partner, there are succession planning issues to be considered. There is the possibility that a sick or deceased person's share of the business could pass to a dependant who is unable to contribute to the running of the business, which could cause considerable disruption.

It is, therefore, important to ensure that the remaining directors or partners can maintain control of the company by buying out a sick colleague's share or that a deceased co-director or partner, or one who has suffered a serious illness.

The purpose of a shareholder protection agreement is to protect the remaining owners in the event of the death of one of the shareholders in a business. These are generally used by smaller privately owned limited companies where the owners and the managers are the same people.

A partnership protection agreement is broadly similar except that it is used by the partners in a partnership or LLP rather than a limited company.

Shareholder and partnership protection insurance is designed to ensure that the remaining owners have the means to buy out this share without disruption to the business or their own personal finances.

The benefit of this for the deceased partner's dependents is that they have a willing buyer and cash. This is preferential to leaving a share of a business which they may struggle to find a willing buyer for and may not have the knowledge or inclination to attempt to run themselves.

The cover also helps bring clarity in what may be a difficult situation as they know what they will receive and do not have to go through what may be a difficult negotiation process in order to sell the holding.

The benefits for the remaining business partners include the following:

- ability to retain full control of the business
- the cover prevents the shareholding from being inherited by an unwanted beneficiary, whose priorities may not align with theirs
- this prevents the possibility of sale to an external party who may be difficult to deal with, or even to a competitor
- it reduces disruption to the business by making the process as orderly as possible
- the flexibility to come to different agreements on how to manage the shares, and
- it helps avoid having to dip into their savings or attempt to raise costly buyout capital.

There are three essential elements which must be in place:

- **A cross option (or double option) agreement** – this must be drawn up, giving the option to the remaining partners or directors to buy the deceased's interest from the beneficiaries, and giving the beneficiaries the option to sell their inherited shares. You should note that this is an option, not a binding agreement. This is important to keep the inheritance tax business relief on the company shares. If either party exercises their option, the other party must comply. If critical illness is used, it is important that a single option agreement is used rather than a double option agreement; this simply gives the ill director/partner the option to sell their shares.

- **Life cover** – this provides the resource to buy the deceased's share of the business from the beneficiaries. If it is affordable, critical illness should also be considered; the sum insured will be for the agreed value of the shares or partnership interest.
- **A trust** – the policy must be written under a special type of trust for the other directors/partners. It is important that a 'business trust' is used rather than an ordinary discretionary trust or flexible power of appointment trust. The beneficiaries must be the other business owners to ensure that **HM Revenue & Customs (HMRC)** views the arrangement as commercial and will not, therefore, suffer adverse IHT consequences.

Example

Keeley, Rohan, Amit and Craig founded Imaginative Accounting Solutions LLP together ten years ago. Each invested a stake of £50,000 at the time. The business is now valued at c £1.5 million.

In order to protect each other's interests, they could establish a life and critical illness policy on each of their lives written under a business trust for each other's benefit. This would be written under a cross-option agreement for a sum assured £375,000 apiece.

This would then allow the remaining partners to buy out the share of a member who passed away or was diagnosed with a specified illness which made their ongoing involvement with the business impractical.

3. Sources of Financial Protection

3.1 State Benefits

Learning Objective

2.3.1 Understand the role of state benefits/local authority-funded solutions: state pension and pension credit; housing, rebates, mortgage repayment and council tax benefits; incapacity, disability, sickness and maternity benefits; state benefits on death; social care provision; universal credit and other tax credits

2.3.2 Be able to analyse the limitations of state benefits and state/local authority-funded solutions for financial protection

2.3.3 Be able to analyse how state and other welfare benefits can be incorporated into a financial plan

State benefits in the UK are wide ranging and should be considered when deciding on the amount of personal financial provision that is required.

We will cover the main state benefits available, including:

- universal credit
- employment and support allowance (ESA)
- jobseeker's allowance (JSA)

- statutory maternity pay (SMP)
- support for mortgage interest (SMI)
- council tax reduction and rate rebates
- bereavement support payment, and
- state social care.

Universal credit has replaced six existing benefits for new claimants (except those entitled to the severe disability premium), with a simpler, single monthly payment if someone is out of work or in receipt of a low income. Universal credit replaces:

- income-based jobseeker's allowance
- income-related employment and support allowance (ESA)
- income support
- working tax credit
- child tax credit, and
- housing benefit.

Existing claimants may still be in receipt of legacy benefits. To qualify for universal credit a claimant must:

- be on a low income or out of work generally be 18 or over
- be under state pension age (SPA)
- not be in full-time education or training
- not have savings over £16,000 (either by yourself or together with your partner), and
- be living in the UK.

The amount of universal credit can go down or up depending on what income the claimant gets from working, a pension, other benefits and savings and capital above £6,000. A partner's savings or income will be taken into account even if they are not eligible for universal credit. To claim a benefit without savings, or a partner's savings or income being taken into account, an application for 'new style' JSA or 'new style' ESA should be made.

3.1.1 Income Support

In order to receive income support, a claimant must:

- be on a low income or out of work generally be 18 or over
- be under state pension age
- not be in full-time education or training
- not have savings over £16,000 (either by yourself or together with your partner), and
- be living in the UK.

The amount varies depending on age and circumstances.

3.1.2 Employment and Support Allowance (ESA)

Employment and Support Allowance (ESA) is a state benefit if there is a disability or health condition that affects how much a claimant can work. There are two versions of ESA:

- **Contribution-based** – this benefit is based on the claimant's national insurance contributions (NICs). To be entitled to ESA, as well as having a disability or injury that affects the claimant's ability to work, claimant's will need to have made enough payments to their NICs accounts over a two-to three-year period.
- **Income-related** – the eligibility to ESA is dependent on the amount of income and capital the claimant has. If a claimant has income-related ESA, the household income and savings worth £6,000 or more may affect how much is awarded. It is worth noting that, unlike income-based ESA, there is no link between contribution-based ESA and saving.

There is a work capability assessment period, lasting up to 13 weeks. During this time, an amount which is dependent on the person's age, is paid by the state.

After this period, if the person is entitled to ESA they are placed in one of two groups: either a work-related activity group or a support group. The amount received is higher for those in the support group.

Other than not being able to work, the eligibility criteria is:

- being under state pension age
- not receiving statutory sick pay (SSP) or statutory maternity pay (SMP) and are not back at work, and
- not receiving jobseeker's allowance (JSA).

3.1.3 Jobseeker's Allowance (JSA)

Jobseeker's allowance (JSA) (previously unemployment benefit) has existed in the UK since before the First World War, when mass unemployment reared its head for the first time. In the slump that followed that war, the number of people receiving the benefit rose to two million, which, as the population was 20 million fewer than today, was a far greater proportion of the available workforce. Today, the amount of JSA that is paid out to unemployed people is dependent on how long they have been out of work and on their circumstances.

The name change to JSA was a deliberate attempt to change the image away from the idea of a payment for being unemployed towards a payment to encourage looking for work. Under the age of 18, JSA is not paid unless there are circumstances that make life very difficult. Those over 18 years old and under retirement age can get JSA if they are out of work, capable of doing it, and can prove that they are actively seeking work.

There are three different types of JSA, namely:

- 'new style' JSA
- contribution-based JSA, and
- income-based JSA.

Only those entitled to the severe disability premium are now entitled to claim contribution-based or income-based JSA. All other new claimants must apply for 'new style' JSA. To be eligible for 'new style' JSA, an individual must meet a number of conditions including: have worked as an employee and paid enough Class 1 national insurance contributions; be between 18 and state pension age; not be in full-time education; and be available to work.

3.1.4 Statutory Maternity Pay (SMP)

In order to be eligible for SMP from their employer, an individual must:

- earn on average at least £123 per week, and
- have worked for the employer for at least 26 weeks continuing into the qualifying week (which is the 15th week before the expected week of childbirth).

If the eligibility criteria is met, SMP is paid for up to 39 weeks. These payments are regarded as income in much the same way as a person's salary and are, therefore, subject to income tax and NICs.

The amount is:

- 90% of average weekly earnings (before tax) for six weeks, and
- £187.18 or 90% of average weekly earnings (whichever is lower) for the next 33 weeks.

3.1.5 Support for Mortgage Interest (SMI)

In the case of loss of income resulting in financial difficulties, including being unable to cover mortgage payments, state provision is very limited.

To receive even the limited help available, a claimant must be eligible for:

- income support
- income-based JSA
- income-related ESA
- **pension credit**, and
- universal credit.

If someone qualifies for full SMI, it only covers the interest on the first £200,000 of the mortgage and the standard interest rate used to calculate the benefit is currently 3.66% as of time of writing, regardless of whether the actual mortgage interest rate is higher.

There is no help given towards repaying the capital part of the mortgage, or any endowment or other linked savings policy.

If pension credit (http://www.gov.uk/pension-credit) is the reason for the claim, the limit is £100,000. The loan usually commences from the date the claimant starts getting pension credit, after nine consecutive universal credit payments, or for any other qualifying benefits, 39 weeks after their initial claim is made. The maximum payment period for those claiming JSA is two years. There is no time limit for other claimants, providing they remain eligible for their benefit.

If the actual interest rate is lower than the standard rate used to calculate SMI payments (ie, more SMI is paid than is needed to meet the mortgage payments), the overpayment can only be credited to the mortgage account; use of funds for other purposes is prohibited.

SMI benefit is paid in the form of a loan to the homeowner. The interest rate is variable, but will not change more than twice a year, and the current rate at the time of writing was 4.50%. This will need to be repaid with interest if their house is sold or if ownership is transferred; voluntary repayments are possible to pay it back more quickly.

3.1.6 Council Tax Reduction and Rate Rebates

Council tax reduction, sometimes known as council tax support, replaced council tax benefit in April 2013. It essentially offers a discount on the annual council tax bill to people who are on a low income or are in receipt of certain other state benefits.

This is generally paid to those are responsible for paying the council tax bill and are on a low income, whether due to inability to work or low paid work. Each local council is responsible for setting its own qualifying criteria, and therefore, the discount on offer may be more generous in some areas than others. However, factors considered would typically include:

- age
- income
- savings
- which benefits are being received
- who the claimant lives with, and
- how much council tax is paid.

Certain council taxpayers may also be entitled to pay a reduced rate of tax. Where the property liable to council tax has only a single occupant, or where all but one occupants are under the age of 18, the property is entitled to benefit from a 25% reduction to the council tax bill.

Rate rebates are paid to those resident in Northern Ireland who are in receipt of universal credit and pay rates to the council, which is the broad equivalent of council tax. Claimants are required to create a rate rebate account online. Rate rebate is available to those claiming universal credit, who are:

- a homeowner living in their own property
- a tenant living in social housing owned by the Housing Executive
- a tenant living in social housing owned by a housing association, or
- a tenant living in private rented housing.

3.1.7 Bereavement Support Payment

This is paid to those:

- whose husband, wife or civil partner died on or after 6 April 2017
- where the survivor is under the state pension age (SPA) and living in UK or a country that pays bereavement benefits, and

- whose partner either paid NICs for at least 25 weeks, or died because of an accident at work, or a disease caused at work.

The first payment is a lump sum followed by up to 18 monthly payments; the amount received depends on circumstances.

There are two rates depending on individual circumstances and children in education (those entitled to claim child benefit are entitled to a higher rate):

Rate	First payment	Monthly payment
Higher rate	£3,500	£350
Lower rate	£2,500	£100

The amount that the surviving spouse will receive depends on their circumstances. For those with children under 20 in full-time education, the surviving spouse will receive a first payment of £3,500 followed by payments of £350 for 18 months.

If the surviving spouse or civil partner does not have children under 20 in full-time education, these amounts are reduced to £2,500, and 18 monthly payments of £100.

The payment must be claimed within three months of the death, however it will still be payable if claims are made up to 21 months, however the payments will be reduced.

Remarriage/re-partnering before the end of the 18-month payment period will not mean that any remaining instalments of bereavement payment are lost.

Widowed parent's allowance may still be payable if a spouse or a civil partner died before 6 April 2017, however, is no longer payable to new applicants. This was payable where:

- the survivor is under state pension age
- they are entitled to child benefit for at least one child whose other parent was the deceased, and
- the deceased paid national insurance contributions or died as a result of an industrial accident or disease.

3.1.8 State Social Care

State social care is provided to those who are in need of long-term care due to physical and/or mental deterioration which requires assistance and which they are unable to fund privately. This can be in the form of paid care in their own home, paid for by benefits such as attendance allowance, or where this is not sufficient, in the form of residential nursing care.

Charging structures differ across England, Wales, Scotland and Northern Ireland. A detailed explanation of the assistance available and the charging structure involved is provided in section 7 of this chapter.

3.2 State Benefits in Financial Planning

When assessing the client's existing cover and the potential need for further cover, it is essential to take into account any state benefits to which they may be entitled. They should be separated into two benefit categories:

- **Potential** – benefits which may become payable on certain events such as death, incapacity, or retirement. This may also include child benefit (if not taken now because of the tax charge, it may become payable if one partner died or was ill).
- **Existing** – benefits currently being received. If these are means-tested, it is also important to know if they would continue, for example, if a partner died and the survivor received a life insurance pay-out.

If these are not included in the financial plan, the plan itself is incomplete: it is also possible that the client may be left either under- or over-insured.

It is important to note that it is not generally considered wise to place reliance on state benefits when producing a financial plan for a number of reasons.

- **Sum payable** – the value of state benefits is generally meagre. It is unlikely, for example, that a person could live for any length of time on the amounts paid by universal credit, which is currently a maximum of £628.10 a month if the claimant is living with a partner and either is over the age of 25. The minimum rate of £316.98 for a single person under the age of 25 would be even less likely to make ends meet.
- **Timescales** – many benefits are only payable for a limited term. For example, bereavement support payment is payable for 18 months only, after which time the claimant would need to replace the income.
- **Conditional nature** – a number of state benefits are imposed subject to conditions which the claimant needs to meet on an ongoing basis. For example, new-style jobseeker's allowance requires the adherence to a 'claimant commitment', which sets out exactly what steps the claimant is going to take to look for work. It can be difficult at times to evidence that the terms are being met.
- **Withdrawable and changeable** – state benefits are a matter of government policy and can be withdrawn, reduced or amended at any point. The state pension age, for example, has been subject to a number of increases over recent years, with further increases due to come into force. The ongoing viability of the triple lock guarantee has also been the subject of speculation as a result of the stretched state of public finances following the Covid-19 pandemic and the energy and inflation crises. It is therefore unwise to rely on the idea that state benefits will be available in their current format if and when required.

4. Life Assurance Policies

Learning Objective

2.4.1 Understand the range of products available for financial protection needs: types of policies, comparative costs, benefits and advantages; cost and premium calculation factors; legal requirements, ownership, uses and relevance of trusts; underwriting and claims; terminal illness benefit and other additional benefits; assignments, surrenders, paid-up policies, claims

2.4.2 Be able to analyse the structure and application of life assurance, and employment-based policies

2.4.3 Be able to interpret the taxation treatment of life assurance policies including: qualifying and non-qualifying life insurance policies, offshore life insurance policies; taxation of life funds (onshore and offshore); capital gains tax (CGT) and life assurance policies; inheritance tax (IHT) and life assurance policies

2.9.6 Be able to analyse estate planning and its application in the financial planning process: the basics of wills and will planning; the events that invalidate wills; laws of intestacy; importance of regular reviews; use of lasting powers of attorney

4.1 Life Insurance Policies

The two main types of life policy used for protection purposes are:

- term insurance, and
- whole of life insurance.

Before we go into detail, we will cover some of the recurring terminology used:

- The 'proposer' is the person applying to the insurance company for a policy.
- The 'life insured' is the person who is being insured, and upon whose death the payment is made.
- The 'insured' is the person who takes out the policy and is the original owner.

Frequently, the life insured and the policyholder are the same person, in which case the policy is known as an 'own life policy'. However, this is not always the case, and the life insured and the insured can be different; these policies are then known as 'life of another policies'.

Most life insurance policies are 'single life', so the death of the life insured will result in the policy paying out and will bring the policy to an end.

Policies can also be written for two insured lives (which is the most common type of multiple life policy, although it is possible to write policies for more). Joint life policies are either:

- **Joint life first death, paying out on the death of the first life insured** – commonly used for family protection needs and for mortgage cover.
- **Joint life second death, paying out on the death of the second life insured** – commonly used in whole of life insurance policies to meet IHT liabilities.

4.2 Term Insurance

Term insurance is the most basic, and inexpensive, form of life insurance. The sum insured will be paid out only if the life insured (the policyholder) dies during the agreed term. If they do not die, a payment is not made, as generally policy does not build up a value; this is known as a surrender value, or cash-in value. The policy then expires.

There are five types of term insurance policy that we will briefly cover in this section, looking at how they are structured, their uses and their merits.

4.2.1 Level Term Insurance

We will start with the most basic form. The sum insured on a level term insurance policy does not vary during the policy term; once the term expires, the policy expires with no value.

Uses

Level term insurance is often used to provide protection against the death of the main earner in a family. This may not be ideal, as most people expect their income to increase and on a level term policy the sum insured remains the same.

Level term policies have also been used to provide cover for an interest-only mortgage. With this type of mortgage, as the name suggests, only interest is paid (no capital) so the liability stays the same throughout the term. For this reason, a level term policy is ideally suited.

Although the NRB of £325,000 has not increased since 2009, an additional NRB was introduced in 2017–18. This is known as the main residence NRB. This band is also transferable and has been phased in over four years. It started in 2017–18 at £100,000 and continued to rise by £25,000 each year to reach £175,000 during the 2020–21 tax year. This applies when a residence is passed on death to a direct descendant. Following the recent significant rises in national debt, both the basic and main residence nil rate band rates are currently frozen until 2030.

Example

Stefan has an interest-only mortgage of £250,000, with ten years remaining. He is concerned about how his family will repay this debt should he die. He plans on 'downsizing' in ten years' time and repaying the mortgage at this time.

A level term policy with Stefan as the life insured for a sum insured of £250,000 with a term of ten years will satisfy this need.

4.2.2 Increasing Term Insurance

With this policy, the sum insured increases – this could be either by a set percentage of say 5% or in line with increases in the rate of inflation.

The initial premium is slightly higher than a level term policy, and increases when the sum insured increases throughout the term.

Uses

This type of policy is also used for family protection, with the added advantage of offsetting the effects of inflation.

4.2.3 Renewable Term Insurance

This type of policy enables the life insured to take out further term insurance at ordinary rates, without providing further evidence of their health status. The length of the renewed term is normally restricted by the original term, and also possibly by a maximum age. Each subsequent policy will have the same renewability option, incorporating the restrictions noted.

The initial premium will be higher than for a level term policy. When the policy is renewed the premium increases as it will be based on the increased age of the life insured.

Uses

This type of policy is used when there is a definite need for cover, but it is not known for how long that need will last.

This will often be the case in key person protection, where an employee is deemed to be a key person initially but it is uncertain for how long.

4.2.4 Convertible Term Insurance

This type of policy allows the policyholder to convert to a whole of life or **endowment policy**. This can take place at any time during the policy term and there will be no need to provide further evidence of their health status.

The initial premium will be higher than that for level term insurance. Significantly, on conversion, the premium will be based on the new type of policy, both of which are much more expensive than term insurance.

Uses

This type of policy is used when there is a current need for term insurance, but also the likelihood of a more substantial requirement in the future.

4.2.5 Decreasing Term Insurance

This type of policy has a sum insured which reduces each year by a given amount, decreasing to zero at the end of the term.

Although the cover decreases, the premium remains the same. The initial premium is lower than level term insurance, as the overall liability to the insurer is less. Often the premiums are payable for less than the full term; this is to remove the temptation for the policyholder to lapse the policy in the last few years when the cover is low.

Uses

Primarily to cover reducing debt, such as a repayment mortgage.

Example

Lydia takes out a repayment mortgage of £400,000, over a term of 25 years. She is worried about how her family will repay this debt if she were to die.

A decreasing term policy with Lydia as the life insured for an initial sum insured of £400,000 over a 25-year period would satisfy this need. The sum insured on the policy will decrease each year as it is designed to reduce in line with a typical repayment mortgage as the outstanding capital reduces.

A special form of seven-year decreasing term insurance, called a gift *inter vivos* policy, can also be used to cover the IHT liability on a gift that exceeds the NRB. Because taper relief reduces the amount of IHT due, depending on when death occurs, the sum insured decreases in line with this.

4.2.6 Family Income Benefit (FIB)

This type of policy provides a tax-free regular income, as opposed to a lump sum, although some providers also offer the option of a lump sum payment.

The income is only paid for the remaining term of the policy, so the closer to the end of the policy that the death occurs, the fewer years' income will be paid.

Many advisers consider FIB to be one of the best value, and most useful, protection products. Because it can provide a monthly income, it avoids the survivors having to make any investment decisions which they might have to if they received a lump sum. The advantages of this include not having to pay fees, potential fund charges and income tax and/or capital gains tax (CGT).

For couples with a young family, and perhaps less disposable income, this product can provide valuable protection at a low cost.

Example

A FIB plan is set up for 20 years to pay £20,000 a year. If a claim is made after five years, £20,000 x 15 years £300,000 is paid, ie, £20,000 x 15 years. However, if a claim is made after 18 years, £40,000 is paid, ie, £20,000 x 2 years. This is why an FIB can cost less than term life insurance, but a family with young children could need a lot of initial cover that decreases when the children are independent.

The income is paid tax-free and does not affect entitlement to bereavement support payment, although it may affect entitlement to any means-tested state benefits.

Example

Nadia is aged 35, a non-smoker, a single parent and is in good health. She earns £100,000 pa as an employee of a large company. She has two children aged four and two.

Nadia has a mortgage and very few savings and would like to make sure that, upon her death, her children have a lump sum left to them to help secure their future. She has asked your advice on taking out life cover.

Some of the key factors to consider include the following:

- **Budget** – what is her available budget?
- **The amount of the sum insured** – a financial planner can work with Nadia to quantify the amount of cover she needs and recommend a suitable sum insured.
- **The term of the plan** – to last until her children become financially independent.
- **How inflation will erode the cover over time** – the sum insured can be indexed.
- **Does she have any life cover provision from her employer?** If so, consider the loss of this should she leave this employer. Does she want to top this up with a separate life policy?
- **Writing the policy under a trust** – this will ensure probate is avoided, meaning the sum insured is paid out quickly; it will also be outside of her estate for inheritance tax purposes.
- **Whether she has a will that appoints guardians** – if death occurs while her children are still minors, the money will need to be looked after for them.

4.3 Whole of Life Policies

As the name suggests, a whole of life policy pays out the sum insured on the death of the life insured, whenever that death occurs. Because the policy will definitely pay out at some point (assuming premium payments are kept up to date), the premiums are more expensive than under term policies.

Whole of life policies can be set up so that they are more aligned to protection needs or that they can be used as investment products.

There are three main types of whole of life policy, namely:

- non-profit
- with-profits, and
- unit-linked.

4.3.1 Non-Profit Whole of Life Policies

This type of whole of life policy guarantees to pay a fixed sum on the death of the life insured. There is no investment element so these policies are very similar to term insurance policies, although the premiums will be higher because of the certainty of payout.

Premiums may be written on a guaranteed or reviewable basis. Guaranteed premiums will remain constant throughout the lifetime of the policy, however, tend to be more expensive at the outset. Reviewable premiums tend to be cheaper initially but, are subject to review and potential increase on a periodic basis, for example, every five years. This can have the effect of making cover more expensive for aging customers at a time when they are reliant on accumulated wealth to fund their outgoings. Underwriting also tends to be rigorous as in most circumstances, the policy will eventually pay out.

4.3.2 With-Profits Whole of Life Policies

With-profits policies include an investment element. On death, the amount paid out is the guaranteed minimum sum insured, plus any allocated bonuses. Bonuses are not guaranteed but once they have been added they cannot later be taken away. The amount of the bonus depends on the performance of the life office and its funds, assets and liabilities.

The types of bonus are:

- **Reversionary bonuses** are paid annually and are usually expressed as a percentage of the sum insured. They may be simple, based purely on the original sum insured, or compound, based on the original sum insured plus previous bonuses.
- **Terminal bonuses** are paid at claim stage (and not usually on surrender) and are usually expressed as a percentage of the total reversionary bonuses.

As mentioned, once a bonus has been allocated it cannot be removed. However, most offices reserve the right to apply a market value reduction (MVR) if a policyholder surrenders their policy, or wants to switch out of the with-profits fund. This is more likely to be applied during periods of adverse stock market conditions and poor economic climate.

The purpose of an MVR is that it allows a life office to reduce the surrender or switch value, in an attempt to apply fairness across all with-profits members (including those who are remaining in the fund). MVRs are not usually applied on death.

The premiums are higher than for non-profit policies, due to the investment element and potential for a higher pay-out.

Uses

As a standard form of whole of life cover, they could be used for family protection and IHT planning. However, for many with-profits policies, performance has been poor, and they have been criticised for not being 'transparent'. For these reasons, there is not a great level of demand in the market.

4.3.3 Low-Cost Whole of Life Policies

This is a product that combines:

- a with-profits whole of life policy, and
- a decreasing term insurance.

The policy pays out the full sum insured on death, based on the combined value of the two policies. Over the longer term, the bonuses added to the with-profits policy increases the payout from that element, while the decreasing term insurance sum insured is reducing.

Example

A low-cost whole of life policy provides a sum insured of £100,000. This might be made up of £60,000 with-profits whole of life cover and £40,000 decreasing term. If the life insured dies immediately, there is a combined pay-out of the required £100,000. Over the years, bonuses are added to the with-profits element, taking it up to, say, £70,000, over ten years. In the same time period, the decreasing term sum insured will have fallen by the equivalent amount to £30,000. The sum insured pay-out on death is, therefore, the same amount of £100,000.

It is worth noting that the decreasing term insurance will not necessarily fall in line with the addition of bonuses. As low-cost policies have a lower sum insured, bonus additions are lower than for a full policy with a higher sum insured.

The attraction of these policies, as the name suggests, is that they are significantly cheaper than full with-profits policies. However, the surrender value will be less than on a full with-profits policy.

Uses

They are used for much the same purposes as full with-profits contracts, but at a reduced cost.

4.3.4 Unit-Linked Whole of Life Policies

Unit-linked policies also include an investment element, with premiums buying units in a chosen fund. Each month sufficient units are cancelled to pay for that month's life cover, while the remaining units stay invested. The value of the policy goes up with increases to unit values; the value of a unit is the value of the fund divided by the number of units held in that fund.

Unit-linked whole of life policies are often referred to as 'flexible whole of life' policies. This is because the level of life cover can be varied between minimum and maximum levels for a given premium.

The policyholder can choose a:

- **standard sum insured** – this is the amount the life office has calculated that it should be able to maintain for the premium, based on an assumed growth rate
- **maximum sum insured** – where the initial sum insured is higher than the standard amount, this results in more units having to be cancelled each month to pay for the cover, resulting in fewer units remaining invested. It is likely, therefore, that at a policy review the premium will have to be increased to maintain that level of cover
- **minimum sum insured** – where the initial sum insured is lower than the standard amount. This will result in fewer units having to be cancelled each month to pay for the cover, with more units remaining invested. The hope is to build up the surrender value at a time when a higher sum insured is not required.

These policies have regular reviews – usually at the tenth anniversary and every five years thereafter. At a review, if maximum cover cannot be maintained for the existing premium, the policyholder can either reduce the sum insured or agree to a premium increase.

Uses

The attraction of these policies is the flexible level of cover, enabling a high degree of protection in the early years (for example, when the insured's children are still dependent) and less protection with more investment in later life (for example, when the insured's children have left home). These policies are also used for estate planning to provide a lump sum to pay any IHT liability.

In essence, the maximum cover option is fairly similar to a ten-year convertible term insurance, with only a small number of units being actively invested.

Example

David has a large estate, with an IHT liability estimated to be £2 million. His financial planner recommends that he sets up a whole of life policy in trust to provide funds on his death to pay the tax due.

David wants a premium that he will be able to afford for the rest of his life, so the financial planner discusses the differences between a policy with a standard sum insured and one with a guaranteed sum insured.

With a standard sum insured of £2 million, it should be possible to maintain this at the quoted premium based on an assumed growth rate. The policy will have reviews in the future, with the first one being on the tenth anniversary.

With a guaranteed sum insured of £2 million, not only is the sum insured guaranteed, but the premium is too; however, the premium is higher than for a standard sum insured policy. There are no future reviews with this type of policy.

Given that David wishes to have certainty about the future costs of the policy he opts for a guaranteed premium.

4.4 Endowment Policies

Endowment policies combine life cover with investment. They had in the past been popular as a way of paying off the capital on an interest-only mortgage.

However, endowments acquired a bad reputation owing to the fact that many policies underperformed and did not provide the amounts expected by policyholders. The 'endowment misselling scandal' in the late 1990s shortly followed.

Endowments are still available but are not as popular today. The different types of endowment policy are discussed below.

4.4.1 Non-Profit Endowment Policies

The most basic type, with level premiums and a pay-out of a fixed sum insured on maturity or death prior to maturity.

Uses

These are very rarely sold; they are expensive as the premium has to be large enough to provide the sum insured at maturity without the benefit of any investment-related bonuses. However, older policies may still be found when reviewing a client's existing provision.

4.4.2 With-Profits Endowment Policies

These types of endowment guarantee that the sum insured will be paid out on maturity, or if death occurs before then. In addition, there are likely to have been reversionary bonuses added during the term, and the possibility of a terminal bonus added at maturity.

Uses

Due to the nature of the pay-outs, these are comparatively expensive and are rarely purchased.

4.4.3 Low-Cost Endowment Policies

These operate in much the same way as low-cost whole of life plans, with two different policies operating under the structure of one:

- A with-profits endowment policy.
- A decreasing term insurance policy.

The sum insured is guaranteed to be paid on death. However, there is no such guarantee on the maturity of the plan, as the amount depends on the bonuses added throughout the term. Often, they rely heavily on the terminal bonus pay-out to determine whether the amount required will be met.

Example

A low-cost endowment might be set up with an overall sum insured of £100,000, made up initially of, say, a £60,000 with-profits endowment and a £40,000 decreasing term policy. After 24 years and 364 days of a 25-year term, the bonuses added to the with-profits element might only have taken the value up to, say, £90,000 – slightly under the amount required. However, on maturity the next day, a terminal bonus of, say, £20,000 might be added, providing sufficient funds to repay the debt and benefiting from a reasonable surplus. The terminal bonus, though, is not guaranteed.

The attraction of these policies is that the initial cost is a lot less than for a full with-profits endowment.

Uses

These were sold as mortgage endowments to repay interest-only mortgages at a (seemingly) reasonable monthly cost. However, low bonus rates resulted in the maturity value often being less than the target maturity amount. As a result, these policies are no longer popular.

4.4.4 Low-Start Endowment Policies

These are very similar to a low-cost endowment policy, except with a lower initial premium which increases over a number of years, typically for the first five to ten years.

Uses

These policies were aimed at those who expected their income to increase across a short period of time.

Unfortunately, due to a lower initial premium, they were often sold to individuals whose income was not likely to rise, or certainly not by as much as was needed to keep up with the payments. These would typically be individuals taking on a large mortgage and having, therefore, to keep their costs as low as possible.

A lot of policies were, therefore, surrendered early, providing a poor return to the policyholder.

4.4.5 Unit-Linked Endowment Policies

These policies work in a similar way to other unit-linked policies, with monthly premiums being used to buy units in a fund or funds.

The maturity value of the policy is the bid price of the units, so they are transparent (particularly compared with an alternative such as a low-cost endowment). As a result, if the maturity value reaches the amount needed to repay a mortgage debt, the policy can be surrendered, saving the cost of future premiums. However, fund performance has often been insufficient to reach the required amount.

Uses

Unit-linked policies in general offer greater transparency, and the possibility of early repayment of a debt is also attractive.

Along with other forms of endowment, the surrender values in the early years are very low owing to the high level of initial charges. Despite this, many unit-linked endowments have been surrendered early.

4.5 Cost and Premium Calculation Factors

The amount of premium depends on various factors, not least whether the policy provides a fixed level of cover or whether it decreases each year. Clearly, a decreasing term insurance policy will cost less than a policy providing a level sum insured.

Similarly, if a whole of life policy is chosen, this will be more expensive than a term insurance which has a fixed term; with the term insurance, payment is only made if death occurs during the term, whereas a whole of policy will pay out whenever death occurs.

The health of the policyholder may increase the premium if they have existing medical issues. Similarly, lifestyle choices such as smoking will also increase the premium – providers have smoker rates and non-smoker rates.

Other factors, such as having a relatively risky occupation or being very overweight, will also push up premiums.

The younger a person is when they take out life cover, the cheaper the premiums will be – this is because the risk of the life office paying out is reduced compared to someone who is much older.

Life policy premiums are calculated using mortality tables – these show what the likelihood is of someone dying before reaching a certain age. In order to make a profit, life offices include expenses and a profit margin within the premium costs which are calculated by the **actuary**.

4.6 Legal Requirements, Ownership, Uses and Relevance of Trusts

There are various requirements for a contract of life insurance to be valid, including:

- capacity to contract
- insurable interest
- consensus ad idem
- consideration, and
- offer and acceptance.

As we have identified, policies can be set up on an own life basis or on the life of another. They can also be set up on a joint life basis; either joint life first death (where the sum insured pays out on the death of either lives) or joint life second death (where the sum insured pays out only when the second life insured dies). A joint life policy can be held as either joint tenants or tenants in common.

4.6.1 Joint Tenants

If a policy is held as joint tenants, then upon the death of one of them, the interest in the policy automatically passes to the survivor.

4.6.2 Tenants in Common

With tenants in common, each person owns an identifiable share in the policy – when one of them dies, their share does not automatically go to the survivor. Instead, it goes into their estate and is dealt with either through the person's will or through the laws of intestacy.

4.6.3 Uses and Relevance of Trusts

A trust is an arrangement which enables assets to be held for beneficiaries. They can be used for a number of purposes, such as:

- family protection
- business protection
- pension schemes
- charitable purposes, and
- tax planning.

There are three parties to a trust, namely:

- the settlor
- the trustees, and
- the beneficiaries.

The settlor is the person who sets up the trust and transfers the legal ownership of the trust property to the trustees. The trustees look after the trust property for the benefit of the beneficiaries who can be anyone the settlor chooses, but they tend to be a spouse/civil partner, children or grandchildren.

There are different types of trusts and here we will consider three, namely:

- a bare trust (or absolute trust)
- an interest-in-possession trust (IIP), and
- a discretionary trust.

With a bare trust, the beneficiary has an absolute right to benefit at age 18.

With an interest in possession trust, the beneficiary has an absolute right to income and is known as the 'life tenant'. They are said to have a 'life interest' in the trust property. Other beneficiaries known as the 'remaindermen' are entitled to trust capital.

With a discretionary trust, no one has an interest in possession and payment of income, and capital is at the discretion of the trustees.

Lifetime gifts of assets into bare trusts are treated as potentially exempt transfers (PETs). PETs fall outside the donor's estate for IHT purposes as long as:

- the transfer is made by an individual
- the transfer was made on or after 18 March 1986
- the transfer was made to another individual or specified trust, and
- the donor survives for seven years after the date of the transfer.

However, if the gift is to a discretionary trust and/or IIP, the transfer (since March 2006) is regarded as a chargeable lifetime transfer (CLT) and is liable to IHT immediately at a rate of 20% if the CLT exceeds the nil rate IHT band.

If a life policy is placed into a trust at the outset, then the payment of each premium is treated as a transfer of value. However, there are IHT exemptions which can be used so the premiums are not treated as gifts. For example, everyone has an annual £3,000 allowance which can be used. There is also an exemption that covers gifts that are made out of someone's surplus income.

Where a policy is set up to provide critical illness benefits as well as death benefits (life and earlier critical illness), a split trust should be used. This ensures that the life insured receives any critical illness payment while any death benefit is paid to the trustees and held in trust for the beneficiaries.

4.6.4 Trusts and IHT

When a life policy is written under a trust, this ensures that it is not included in the estate for IHT purposes.

Let us consider the situation where a life policy is not written under a trust. If this happens, the policy is paid into the estate of the deceased and increases any liability to IHT. IHT is currently paid on assets over £325,000 (2025–26) and, is charged at a rate of 40%.

Example

Jordan has an estate of £800,000 and is not married and not in a civil partnership. He set up a life insurance policy with a sum insured of £100,000, and this was not written under a trust. Jordan dies in April 2021. The life policy pays out £100,000 which is included in his estate. He benefits from the nil rate band of £325,000, together with the residence nil rate band of £175,000. The remainder of £400,000 will be charged at 40%, thus creating an IHT bill for his personal representatives of £160,000.

If the life policy had been written in trust, the sum insured would not have been included in his estate, and the IHT bill would be £40,000 less.

Another important advantage of using a trust is that the sum insured can be paid out without waiting for probate. This means that there is no delay and the beneficiaries receive the money relatively quickly.

4.6.5 Underwriting and Claims

Underwriting is a process that applies to applications for life cover, critical illness cover and income protection and in which the insurer assesses the amount of risk the potential policyholder presents to them. Through the underwriting process, the insurer determines whether the individual is eligible for cover, and if so, how much the premium and the terms are likely to be.

Insurers carefully assess each application, taking into account the level of risk associated with each of the following factors:

- **Age** – the cost of buying insurance cover increases as someone gets older because the risk factors increase.
- **Health** – certain medical conditions carry a greater risk of death or disability. Typical conditions include raised blood pressure, high cholesterol levels, heart disease, diabetes, stroke or cancer. Some conditions such as back/joint problems, or anxiety and depression, are especially significant when applying for disability cover.
- **Weight** – people who are overweight are more likely to suffer from conditions such as diabetes and heart disease. The medical profession sets out recommended guidelines for an individual's ideal body mass index (BMI). If a person has a high BMI ratio, insurers may decide to increase their premium or in certain circumstances, may not be able to offer cover at all.
- **Family history** – certain conditions, such as heart disease and some types of cancer can be hereditary. So, it is important that relevant questions are asked about family medical history.
- **Hazardous activities and occupations** – some jobs or hazardous activities carry an increased risk of accidental death or ill health. Examples include diving, mountaineering, private aviation, working at heights and certain roles in the armed forces.
- **Smoking, alcohol and drugs** – using tobacco products, non-prescription drugs and alcohol consumption over the recommended limits are well-recognised risks. Applicants who have not used any tobacco products in the last 12 months will pay lower premiums, as they are less likely to suffer the health problems associated with smoking.
- **Residency and travel** – living or travelling abroad, including past or potential future travel or residency, may influence an underwriting decision.
- **Terminal illness benefit** – terminal illness benefit is an additional benefit which is usually included in life policies. It will pay out if a terminal illness is diagnosed and medical evidence suggests that the policyholder has less than 12 months to live. Once this payment is made, the policy comes to an end; it can be viewed as an accelerated death benefit rather than in addition to the death benefit.

Claims

Claims need to be dealt with quickly, efficiently and with empathy. A valid claim will be subject to various checks, including checking that all the premiums have been paid, providing the policy document, and providing proof of:

- **death** – evidenced by an official death certificate
- **title** – evidenced by the appropriate grant of representation, and
- **age** – evidenced by an official birth certificate.

4.6.6 Assignments

An assignment occurs when a policy (usually a life policy) is transferred from one person to another.

Where a policy is gifted, or sold, to someone else (on the secondary endowment market) the assignment will be absolute (or permanent) which means that all interests in the policy are assigned to the assignee/transferee. This needs to be done in writing, and usually by completing a deed of assignment.

A mortgage is also a type of assignment. This is where an asset being used as security for a loan (ie, the property) is mortgaged to the lender for the term of the loan. This is not an absolute assignment as when the mortgage loan is repaid, the property is reassigned.

4.6.7 Paid-Up Policies

If a policyholder can no longer afford to pay the premiums on their policy, then the life office can convert it to a paid-up policy. This is only possible if the policy has a surrender value. The advantage of this route is that the policyholder would still have a reduced amount of protection in place despite not paying any more premiums.

The alternative is that the surrender value of the policy is paid.

4.6.8 Employer-based Policies

Life cover, or death in service cover, is a benefit that can be offered as part of an employer's benefits package.

Employers use economies of scale to buy life cover at a considerable discount to the price that would be paid if individuals were to purchase the same benefits.

Additionally, due to increases in life expectancy, the cost of life insurance has decreased. Employees need to be wary, however, of the implications of changing jobs, as their cover is rarely allowed to continue. Individual life policies after leaving an employer will be based on age and health at that time.

Likewise, employees need to be aware that even if a new employer has a death in service scheme, it may be that the individual's required level of cover is above any medical free underwriting limits; this is becoming more of an issue in the current fluid job market of the UK.

4.7 Life Insurance in a Defined Contribution (DC) Environment

As employer contributions to defined contribution (DC) pension schemes tend to be lower than to defined benefit (DB) schemes, and greater flexibility has arisen in possible benefits, employers have found it cost-effective to increase life cover protection, as well as make pension contributions.

As premiums have reduced, employers have opened up life cover to employees who are not enrolled in their workplace pension scheme. Additionally, life cover of up to ten times salary is offered by some employers to encourage employee retention. Even set levels of cover that increase with seniority have started to be offered.

In order to offer life cover benefits tax-free, these must be paid through a discretionary trust. Employers do not need to establish their own trust; they can simply agree to participate in the life office's master trust. It is separate from the workplace pension, enabling this benefit to be offered to employees who are not scheme members.

As discussed, greater flexibility and lower costs have made offering life cover for employees an attractive option for employers. There are, however, some areas to consider. Group life insurance policies are generally available without the requirement for each employee to have a medical examination or to provide medical evidence; this is called the free cover level (ie, free of medical underwriting) and becomes higher the larger the scheme. Some higher-earning employees, or those with medical complications, may face restrictions. If a firm has many employees on long-term sick leave, then a change in life insurance provider or type of cover may be difficult.

Taking these issues into consideration, the exact premium paid will vary. However, generally, an employer providing cover of four times earnings should pay in the region of 0.25–0.5% of the payroll. Regular reviews are recommended, because cost savings may be made as premiums across the industry reduce.

DC pension schemes do not usually include pensions for dependants after the scheme member's death. Within this environment, this benefit will be provided by paying the value of the pension fund, plus any additional life insurance if it was taken out.

A tax-free lump sum rather than a regular pension (which is taxable) is often preferred. It is much easier to understand for employees and provides an immediate benefit to dependants.

4.8 Taxation of Qualifying and Non-Qualifying Policies

The tax treatment of a life insurance policy is determined by whether it has qualifying status or non-qualifying status.

The qualification rules are as follows:

- The policy term is at least ten years.
- Premiums are payable at least annually.
- Premiums are subject to an annual limit of £3,600.
- The sum insured is not less than 75% of the premiums payable over the term.
- Premiums paid in any one year are not more than twice those paid in any other year.
- Premiums paid in any one year are not more than 1/8 of premiums paid over the term.

You should note that:

- the annual premium limit of £3,600 has been in place since 6 April 2013
- the annual premium limit is an aggregate amount that generally applies to all qualifying policies held by an individual, and
- qualifying policies issued before 21 March 2012 are protected policies, and, as such, will not usually be affected by the annual premium limit.

Life policies pay corporation tax within the fund, which is deemed to satisfy the basic rate of income tax.

If a policy has qualifying status, this means that the proceeds are not subject to income tax regardless of the tax status of the policyholder.

You should be aware, however, that a qualifying policy can lose its qualifying status which would result in it being potentially liable to tax. Examples are where a policy is surrendered or assigned within ten years, or ¾ of the term if this is less – and if premiums exceed £3,600 pa.

4.8.1 Non-Qualifying Policies

One of the qualifying rules is that that premiums are paid annually or more frequently – in other words, they need to be paid regularly. As a result, any single premium life policy is non-qualifying meaning that any gain could be subject to income tax. The fund suffers tax equivalent to the basic rate of income tax. Non-taxpayers cannot reclaim this tax; basic rate taxpayers have no further liability, and higher-rate and additional-rate taxpayers have an additional liability in this tax year of 20% or 25% of the chargeable gain.

This liability is only calculated when a chargeable event occurs. The main chargeable events are as follows:

- **D**eath.
- **A**ssignment for money or money's worth.
- **M**aturity.
- **E**xcess withdrawals (over a specified limit).
- **S**urrender.

The list above forms the mnemonic DAMES which may help memorise what the chargeable events are.

When a chargeable event occurs, a chargeable gain is calculated. An individual investor in a single premium life insurance bond can withdraw 5% of the original investment each year, with no immediate tax liability, for a maximum of 20 years or until 100% of the original investment has been received.

The 5% allowable withdrawals are cumulative and so, if they are not used, they can be carried forward to be used in later years. It is important to note that these withdrawals are not tax-free; they are simply tax deferred.

Example

Harry invested £50,000 in a single premium life assurance bond (SPLAB) just over nine years ago. He has never made any withdrawals. As he is now in the tenth policy year, he is allowed ten 5% withdrawals without an immediate tax liability. He is, therefore, able to withdraw up to £25,000 on this basis.

As we can see from the list of chargeable events, a partial surrender over the permitted limit will result in an immediate tax liability. So, if Harry withdrew £35,000 rather than the £25,000 he is entitled to, it would be a chargeable event and a chargeable gain would have to be calculated. Whether Harry has any additional tax to pay would depend on his tax status at the time of the chargeable event.

'Top-slicing' relief can help to reduce the tax liability on any excess. To calculate this, the excess is divided by the number of complete years that the bond has been held (or since the last chargeable event, if more recent). The amount of the top-slice is added to the policyholder's taxable income. If any part of the slice falls into the higher-rate tax band (and the additional-rate band, where applicable), it is taxable at the difference between higher/additional rate of income tax and the basic rate of income tax that is deemed to have been suffered in the fund. For offshore policies, there is no deduction for basic rate income tax suffered in the fund.

The total tax due is then calculated by multiplying the amount of tax on the top-slice by the number of complete policy years that the bond has been held (or by the number of complete policy years since the last chargeable event, if more recent).

Top-slicing can reduce the amount of tax liability if none of the taxable income, before the top-slice, would have been subject to tax above the basic rate.

Example

Carly invested in an onshore SPLAB just over five years ago. On encashment today, she realised a chargeable gain of £50,000. Carly's only other taxable income (ie, after allowances) is her £30,000 salary.

Step 1 – Carly's total taxable income and resulting tax bill

- Salary falling in basic rate tax band – £30,000 @ 20% = £6,000
- Gain falling in personal savings allowance – £500 @ 0% = £0
- Gain falling in remaining basic rate tax band – £7,200 @ 20% = £1,440
- Gain falling in higher rate tax band – £42,300 @ 40% = £16,920
- Total income tax on gain = £18,360

Step 2 – Tax due on Carly's £50,000 gain

- Tax on gain – £1,440 + £16,920 = £18,360
- Less, basic rate tax deducted at source (£50,000 @ 20%) = £10,000
- Tax remaining = £8,360

Step 3 – Annual equivalent

- £50,000 / 5 (complete policy years) = £10,000

Step 4 – Tax on annual equivalent of £10,000

- Gain falling in personal savings allowance – £500 @ 0% = £0
- Gain falling in remaining basic rate tax band – £7,200 @ 20% = £1,440
- Gain falling in higher rate tax band – £2,300 @ 40% = £920
- Tax on annual equivalent – £1,440 + £920 = £2,360
- Less, basic rate tax deducted at source (£10,000 @ 20%) = £2,000
- Tax remaining = £360
- Multiply back up by 5 (complete policy years) = £1,800

Step 5 – Top-slicing relief given

- Step 2 minus Step 4
- £8,360 – £1,800 = £6,560

Carly's liability after top-slicing relief is therefore £7,800. From her total liability to tax of £24,360 (Step 1), we deduct the £6,560 top-slicing relief (Step 5) and the basic rate tax credit of £10,000 (£50,000 @ 20%), leaving £7,800. If Carly had taken out an offshore bond, the five-step process to follow is identical, except that we only deduct the top-slicing relief from her total tax liability at the very end of our calculation. There is no deduction for the basic rate tax credit.

The same basic concept applies to a full surrender, although the calculation is slightly different.

A similar calculation on full surrender can take place if partial surrenders have been taken within the 5% limit.

Example

Let us assume that Harry has never taken any withdrawals, but instead chooses to totally surrender the investment bond in the tenth policy year. The surrender value is £62,000 (based on his investment of £50,000). When top-slicing a full surrender, we must use full policy years in the top-slicing calculation:

So, (£62,000 – £50,000) / 9 = £1,333.33.

This is then, again, added to Harry's taxable income for that tax year.

If we again assume he has taxable income of £30,000:

£30,000 + £1,333.33 = £31,333.33

This is still below the basic rate band for 2022–23 of £37,700.

Therefore, Harry has no additional tax to pay.

If we then assume he has taxable income of £37,000:

£37,000 + £1,333.33 = £38,333.33

This is £633.33 over the basic rate band for 2022–23 of £37,700.

£633.33 is taxed at 20% = £126.67

We then need to multiply by the number of full years the plan has been running:

£126.67 x 9 = £1,140.03, which is Harry's tax liability on the surrender.

Example

Let us assume that Harry took a £25,000 withdrawal, as he was entitled to, in the tenth policy year. He then took no further withdrawals but chose to surrender the plan fully after 18 years, when the value of the policy was £55,000.

His chargeable gain is:

(£55,000 (policy value) + £25,000 (untaxed withdrawals)) – £50,000 (original investment) = £30,000

Remember, when top-slicing a full surrender, we use full policy years in the top-slicing calculation:

So, £30,000 / 18 = £1,666.66.

This is then, again, added to Harry's taxable income for that tax year.

If we firstly assume he has taxable income of £30,000:

£30,000 + £1,666.66 = £31,666.66

This is under the basic rate band for 2023–24 of £37,700.

Therefore, Harry has no additional tax to pay.

If we then assume he has taxable income of £37,000:

£37,000 + £1,666.66 = £38,666.66

This is £966.66 over the basic rate band for 2022–23 of £37,700.

This £966.66 is taxed at 20% = £193.33.

We then need to multiply by the number of full years the plan has been running:

£193.33 x 18 = £3,479.94 which is Harry's tax liability on the surrender.

When an investor is already a higher rate taxpayer when a chargeable event occurs, top-slicing is not relevant and the chargeable gain is simply multiplied by 20%.

One last point to make is that, when a chargeable gain is assessed following a chargeable event, that particular gain will not be part of any future calculations. For example, when Harry took a partial surrender of £35,000, £10,000 was assessed, as that was over his entitlement of £25,000. That £10,000 figure will not form part of any future chargeable gain calculation, although the £25,000 will.

4.8.2 Using Non-Qualifying Policies as Investments

There is a debate in the financial services sector about the use of single premium investment bonds as investments as opposed to, say, unit trusts and open-ended investment companies (OEICs). Despite the fact that they may be invested in roughly the same types of assets, their tax treatment is very different.

Investment bonds suffer tax in the fund, and, in isolation, that would appear to be a good reason for using the more tax-efficient unit trusts and OEICs, as the fund should grow more quickly.

Non-taxpayers can never reclaim the tax paid in SPLABs, whereas no tax is payable by the fund manager on income or gains within unit trusts/OEICs.

Withdrawals from bonds do not count as true income as they are classed as returns of capital; they can, therefore, be very tax efficient for higher rate taxpayers.

Owing to the ability to defer a tax liability, an investor can wait for an appropriate time to create a chargeable event. The most obvious example is to invest in a bond when they are a higher rate taxpayer and wait until they are a basic rate taxpayer; for example, following retirement, to create a chargeable event by surrendering (or part-surrendering above the 5% cumulative amounts) the policy.

The proponents of unit trusts and OEICs argue that the ability to limit tax from these products is more under the investor's control, (ie, through the use of the CGT annual exempt amount and individual savings account (ISA) wrappers) and, therefore, the above arguments carry little weight. Even if they pay CGT, it is a lower rate than income tax.

These types of policies are exempt from individual CGT in the hands of the original investor. Some policies, mainly qualifying, are sold on (ie, assigned to a new owner) and it is possible that these will be liable to CGT in the future.

As with qualifying policies, non-qualifying policies can be written in trust to help avoid an IHT liability. Indeed, many investment bonds written under trust have helped reduce IHT liabilities.

4.8.3 Offshore Bonds

Bonds located in places such as Dublin, the Isle of Man or the Channel Islands are called offshore bonds. These products offer growth on their funds that is largely free from any tax within the fund (known as 'gross roll up').

On withdrawal, however, because there is no deemed tax paid in the fund, this means that the investor is taxed at their marginal rates of income tax.

Example

Going back to the example of Harry:

£37,000 taxable salary + £1,000 top-sliced gain = £38,000

This is £300 over the basic rate band for 2025–26 of £37,700.

£700 of the gain falls within the basic rate band and is, therefore, taxed at 20% = £140.

The £300 that falls into the higher rate tax band is taxed at 40% = £120.

We then need to multiply by the number of years the plan has been running:

£260 x 10 = £2,600

Harry will have an income tax liability on the gain of £2,600.

4.9 Capital Gains Tax (CGT) and Life Insurance

A gain made under a UK life insurance policy is not generally subject to CGT unless it had, at an earlier time, been acquired by a person for consideration (eg, the policyholder may have sold the policy on the secondary market, in which case it would have been assigned to that person). In these circumstances, the aim of the CGT legislation is that any gains made on the policy after it has been sold should be chargeable on the new policyholder, just as gains on any other type of investment are chargeable. The effect, therefore, is that a policy is exempt from CGT in the hands of the original owner, and anyone who acquires it from the original policyholder by way of a gift.

Once 'actual consideration' has been given for the policy, the exemption is lost and any gain on a subsequent disposal is chargeable. The capital gain is calculated by deducting the purchase price from the disposal proceeds (the receipt of the sum insured or the surrender value would both count as the disposal proceeds). In addition, premiums paid by the new owner are deductible as would any incidental costs of acquisition or disposal.

4.10 IHT and Life Policies

The proceeds from a life insurance policy are payable to the estate of the deceased life insured, or to the estate of the policy owner. This means that the proceeds form part of an individual's estate and, therefore, could be subject to IHT.

If the policy is written under trust, the proceeds do not fall into the policyholder's estate and are, therefore, not subject to IHT. Apart from protecting the proceeds from IHT, the trust also allows the proceeds to be paid immediately to the named beneficiaries without waiting for probate to be granted.

Trustees are appointed at the outset when the trust is created, which is usually when the life policy is taken out. However, a life policy can be written into trust later which can happen when a financial planner is carrying out a review. Trust documentation usually appoints the settlor, ie, the policyholder, as the first trustee. It is generally advisable to appoint at least one other who can administer the policy when the policyholder dies. You should note that it is possible for just one trustee to administer the claim on death. In fact, the more trustees there are, the more complicated the claim process can be as all trustees will need to sign the claim form. The beneficiaries may also be trustees, and this can often make the claims process easier.

5. Income Protection

Learning Objective

2.5.1 Understand the following: definitions, exclusions, premium calculation factors; underwriting and claims; taxation treatment; special treatment of business income protection

2.5.2 Be able to evaluate: the types of policies available; features and uses; comparative costs; advantages and disadvantages

2.5.3 Know the range, structure and application of income protection insurance options relating to group policies

5.1 Features of Income Protection

Having looked at life insurance products, we will now examine the products that provide benefits in the event of the ill health or incapacity of the life insured, starting with income protection.

Income protection is a long-term policy and is designed to pay a regular income in the event of illness or incapacity. An important factor to consider is the definition used by the insurer to define incapacity. It could be any of the following where the policyholder is unable to perform:

- **Own occupation** – their own occupation and are not working in another job.
- **Suited occupation** – an occupation suitable to them given their education, training and experience.
- **Any occupation** – any occupation at all.

If an individual has a policy with 'own occupation' covered, then this means that if they cannot perform their own job, the policy will pay out regardless of whether they could do something else they are suited to, or indeed any job. These policies offer the most security and so are the most expensive.

Where someone is not employed or has 'houseperson' cover at the time of a claim, then activities of daily living (ADLs) will be used – this is an analysis of a number of defined functions, such as dressing and undressing, washing, eating, climbing stairs, shopping and cooking. The policy will define the number of functions and their definitions.

5.1.1 Benefit Limit

All policies will limit the benefit payable to a percentage of the policyholder's earnings prior to their incapacity; earnings may include bonuses, overtime and commission. Insurers would normally consider this over the 12 months prior to the claim, though some may take an average over a longer period to determine the benefit payable. The limit is usually around 50–60% of gross earnings, but this will vary between providers. State benefits may also reduce the maximum benefit, as will benefits from any other policy.

5.1.2 Deferred Period

The payment of benefits does not commence until a person has been unable to work for a period of time – this is known as the deferred period and could be four weeks, 13 weeks, 26 weeks or 52 weeks. The deferred period chosen will have a significant impact on the premium; specifically, the longer the deferred period, the lower the premium. If someone receives sick pay from their employer, the deferred period would usually tie in with this such that benefit payments start when employer sick pay stops.

5.1.3 Proportionate Benefit

If someone recovers health, but can only return to work in a reduced capacity, many insurers will pay a reduced benefit – this is known as 'proportionate benefit' and is paid until the individual returns to their pre-incapacity earnings.

5.1.4 Rehabilitation Benefit

This is also a reduced level of benefit that is designed to top up earnings when someone returns to work but to a lesser paid job or part-time role. Let us assume that the policyholder's benefit amount is £30,000 pa and an illness occurs that stops them from carrying out their occupation.

The policyholder may take a part-time job that pays a salary of £10,000 pa. Income protection insurance recognises that the policyholder is still unable to earn their normal salary due to the nature of the accident/illness, thus the gap of £20,000 between the part-time salary and the original benefit is filled by the insurance company and the policyholder will still receive £30,000 pa.

5.1.5 Residence

Income protection policies are only valid while the policyholder is permanently resident in the area defined in the policy. This area will be at least the UK, probably the EU or Western Europe and could include the US and other developed countries. Most policies will allow holidays and temporary residences outside of this area.

5.1.6 Premiums

There are three types of premium basis available:

- **Reviewable premiums** – a reviewable premium may start off relatively low, but is reviewed regularly. In some cases, the premium is reviewed every year, or every five years, to take into account changing circumstances.
- **Renewable premiums** – these are short-term policies with guaranteed renewal, at which point the premiums are reviewed in line with current rates and the policyholder's age.
- **Guaranteed premiums** – guaranteed premiums are more expensive than the previous options but they are fixed for the life of the policy, which may be as long as 25 years or the maximum term offered by the insurer; these premiums, therefore, offer security.

Income protection premiums are affected by a number of different factors including:

- amount of benefit required
- term
- age
- smoker status
- occupation
- hobbies and pastimes
- deferred period
- increasing or level cover
- whether own occupation or any/suited occupation, and
- medical history.

Occupations are split into classes, typically ranging from 1–4, with Class 1 being the least risky, admin-based jobs and Class 4 being skilled workers in hazardous jobs and heavy manual work. Some occupations are simply too risky and are excluded altogether, examples of which might include rig welders and professional rugby players.

Basic insurer rates will be applied to Class 1 occupations, whereas rates for those people who carry out occupations from Class 4 will be loaded to reflect the extra risk they present.

5.1.7 Underwriting

The underwriting for income protection is a lot stricter than for life insurance and, frequently, certain pre-existing conditions (such as knee or back problems) are either excluded outright, or are subject to a moratorium. The lower the price of the policy, the greater the limitations and restrictions on the protection offered, unless the policy is offered via an employer, where a bulk-buying discount may apply.

The underwriter of an income protection policy is concerned with morbidity, which is the chance of someone becoming ill. As well as looking at the individual, they will also consider morbidity rates and their own claims experience.

5.1.8 Claims

As soon as someone becomes too ill to work, they should contact their insurer as any delay will increase the deferred period. As soon as a claim is made, the deferred period starts.

Most policies will have common exclusions, including:

- misuse of drugs or alcohol
- self-inflicted injury
- participating in a war
- normal pregnancy and childbirth
- infection due to, or caused by, AIDS and HIV (with some exceptions)
- engaging in hazardous sports and pastimes
- criminal acts committed by the policyholder, and
- failure to follow medical advice.

A claim may also not be successful as a result of a pre-existing illness.

As soon as the insurer is satisfied that a claim is valid, and the relevant deferred period has elapsed, the claim will start to be paid. This is paid normally until the person returns to work, or to the end of the policy or if death occurs.

5.1.9 Taxation

Someone with a personal income protection policy will receive benefits free of income tax. If someone receives income protection payments through their employer (ie, via a group income protection policy), then these are usually taxable as earned income.

Example

Meghan earns £40,000 pa gross. She works in a managerial role and does not take part in any activity that would be considered hazardous. If she were to suffer a long-term illness, or have an accident meaning that she could not work, her employer would pay her salary for three months. Meghan has an income protection policy with a deferred period of 13 weeks; when this expires, she would receive £24,000 pa (ie, 60% of her gross income) tax-free from her policy.

From a planning perspective, her normal monthly outgoings would need to be established, as well as the level of any other income she might receive and whether she has any savings to cover emergencies.

Uses

An income protection policy can benefit almost anyone who is working.

For an employed person, the benefit can be tied in with any sick pay they receive from their employer.

For a self-employed individual, the deferred period might have to be shorter, but the need might be greater, as it is possible that illness could lead to all income stopping.

Some firms also offer income protection cover for 'homemakers', conscious that an illness can lead to greatly increased costs if the partner who normally looks after children and the home becomes too ill to do so.

5.2 Group Income Protection

Group income protection is something an employer will put in place for their employees. It is designed to pay a proportion of an employee's salary if they are off work for a prolonged period due to accident or illness.

Sickness and absenteeism can place an enormous strain on company financial resources, so having this type of policy helps the employer to manage long-term sickness more effectively. At the same time, employees feel that they have the support of their employer during a difficult and stressful time.

5.2.1 Benefits of Group Income Protection

The employer benefits in the following ways from group income protection:

- Employer/employee relations are strengthened.
- The company can provide financial support to employees at a reasonable cost.
- The company can manage the cost of sickness and any associated costs more effectively.
- The premiums qualify for corporation tax relief.
- Company pension scheme contributions and employer NICs can also be included.
- The company can benefit from policy provider rehabilitation schemes.

The employee benefits in the following ways from group income protection:

- Continued sick pay.
- Support from the employer.
- A rehabilitation scheme provided by the insurer.
- The premiums are not treated as a benefit-in-kind.

5.2.2 Product Features

Group income protection policies can be set up with a deferred period of 13, 26, 28, 52 or 104 weeks; the longer the deferred period, the lower the premium.

The policy is very flexible in how it is set up. Indexation, pension contributions, NICs and salary limitations can be included. Most policies offer minimal administration set-up, and normally it is only the higher earners in the company that need medical underwriting.

5.2.3 Unemployment Cover Limitations

Any income protection plans covering unemployment/redundancy have limitations. There is usually, for those taking out a new policy, an initial exclusion period before they are eligible to receive benefits. This always applies to redundancy cover and is typically around 90 days. Against that, the policyholder may be entitled to three months' notice before being made redundant anyway.

- The unemployment/redundancy section of such a policy will not be relevant for those who are self-employed, as they cannot make themselves unemployed or redundant.
- If the policyholder has any hand in making themselves unemployed, the cover does not apply.
- Workers on short-term contracts are not covered for end of contract.
- Seasonal/casual work is not protected by income protection plans.

5.2.4 Who Should Consider Income Protection?

Income protection insurance should be considered by those who:

- are employed and their employer only pays full salary for a limited time in the event of accident or illness
- are self-employed and without the ability to work, their income will cease
- have dependants who rely on their income
- have a lifestyle that they will not be able to maintain without a regular income, and
- do not have sufficient savings to draw on, except perhaps for a limited time only.

5.2.5 How Many Times Can Claims Be Made?

The policyholder can claim as many times as necessary, and during a claim period monthly premiums are waived by the insurer.

5.2.6 Taxation

A business income protection policy is tax deductible as a business expense against the business' own tax bill. This is usually corporation tax in the case of a limited company.

The proceeds are theoretically taxable as profit. However, given that they are generally paid onwards to the employee, who is then taxed under PAYE, this is also deductible as an expense for the business. The overall effect is, therefore, neutral.

6. Critical Illness Protection

Learning Objective

2.6.1 Be able to evaluate: types of policies available; structure; comparative costs; advantages and disadvantages

2.6.2 Know market developments for critical illness insurance

2.6.3 Know the following: definitions, conditions, exclusions; terms and amount of cover – factors, assessment; premium calculation factors; underwriting and claims: issues and processes; claims

2.6.4 Be able to evaluate the taxation treatment of critical illness protection

2.6.5 Understand the interaction between critical illness insurance and life assurance

2.6.6 Be able to evaluate the range, structure and application of critical illness protection in relation to group policies

6.1 Critical Illness Cover (CIC)

While an income protection policy provides regular income in the event of sickness or disability, a critical illness policy is designed to pay a tax-free lump sum upon the diagnosis of a specified critical illness.

The list of illnesses covered by life offices differs, but the majority of claims are for cancer, heart attack or stroke, and there is a set of standard critical illness definitions, which most insurers have adopted.

When CIC started to be marketed in the UK in the late 1980s and early 1990s, most policies were whole of life policies attached to life cover. The market soon changed to offer term-based products, with CIC operating as a stand-alone benefit. This stand-alone nature introduced the concept of the survival period, with the insured having to survive after diagnosis by, typically, 14 or 30 days before the claim is paid. This supports the notion that CIC is 'survival insurance'.

Most CIC policies are now reviewable which means that premiums are only guaranteed for a fixed period of the overall term, say for the first five years.

Due to ever-changing advancements in medicine, this is an important safety net for life offices. With diagnosis techniques becoming progressively more advanced, the likelihood that an illness covered under the policy will be diagnosed earlier than anticipated is growing, leading to earlier pay-outs for insurers.

It is important to note that policy reviews do not look at the health of the individual policyholder, but at general medical advancements. A number of providers use the Association of British Insurers (ABI) definitions for critical illness which means that in some cases, the condition has to reach specific criteria before benefits will be paid. In addition, some providers also offer 'buy-back' cover, which enables someone who has been diagnosed with a critical illness to have a limited level of post-claim cover when they would ordinarily be considered to be uninsurable.

Uses

CIC is designed to provide a lump sum to meet certain costs that may arise during or after a serious illness; for example, adapting the house, buying a different car, additional medical care, recuperation costs or a contingency fund for unforeseen expenses.

Over the years, it has also commonly been used to protect a debt, particularly a mortgage: this could be either on a level basis or on a decreasing basis.

CIC is also used in business protection insurance.

Example

Shannon is concerned that, in the event of a critical illness, she would need a lump sum to help her repay her mortgage and fund her lifestyle. Having worked with her financial planner she takes out a critical illness policy for a sum insured of £500,000 over a term of 20 years (to her expected retirement age).

Should she be diagnosed with a serious illness, and make a successful claim, she would use the capital to clear her mortgage of £50,000 and to provide capital should it be required to make changes to her home. She would then invest the remaining sum to provide her with an income to support her lifestyle.

Where a policy is set up to provide critical illness benefits as well as death benefits (life and earlier critical illness), it is important that a split trust is used. This ensures that the insured person receives any critical illness payment while any death benefit is paid to the trustees and held in trust for the beneficiaries. If an ordinary discretionary trust or flexible power of appointment trust was used, the person insured would not be able to benefit as the settlor (the person who sets up the trust) is not normally included as a beneficiary for IHT reasons.

6.2 Group Critical Illness Cover

There are a growing number of employers offering group critical illness cover to employees. The principles are the same in that the plan will pay out a tax-free lump sum on the diagnosis of a specified critical illness after a defined survival period.

For an employer, group CIC provides:

- **an attractive benefits package** – helping to recruit and retain high-calibre staff
- **an affordable employee benefit** – the cost is low due to the averaging of risk and economies of scale, and
- **financial support** – to help employees during tough times, as well as easing the pressure on the company regarding maintaining long-term financial support.

For an employee, group CIC provides:

- **financial protection** – providing a tax-free lump sum of money when it is needed most
- **peace of mind** – easing financial stress while going through medical treatment, and
- **a feeling of being valued** – employees feel appreciated, which should improve their loyalty.

Products either provide a sum insured as a multiple of salary or as a fixed sum and can include children (often at no extra cost), spouses and civil partners (for additional cost).

The exact level of cover provider will be the subject of an agreement between the employer and the provider. Most employees are covered under a provider's 'free limit'. This is the maximum amount of cover provided without the employee needing to give medical evidence. Cover above the free limit will require medical evidence, but this can normally be completed over the telephone.

The illnesses covered by group policies are usually the same as those covered under individual policies although claims will not normally be paid for pre-existing conditions.

Any claim is usually paid tax free, directly to the employee; however, if the premium is paid by the employer, it will be treated as a benefit in kind and taxed on the employee under PAYE.

The cover stops when the employee leaves service or retires.

6.3 Key Person Insurance

Key person insurance is something that smaller businesses may wish to consider as they are less likely to be able to purchase group critical illness insurance due to their smaller numbers.

Smaller businesses are also usually more reliant on specific key members of staff. In the event that such a person suffers a critical illness and is unable to work for an extended period of time, the business would be adversely affected.

Key person insurance provides the same type of protection as group critical illness cover. It takes away the financial stress and worry of losing a vital member of staff, while providing a means of financially replacing that employee's lost economic benefit to the company. A lump sum paid to the company will also help to replace the potential loss of profit through losing a key person.

The key factors to take into account when taking out critical illness cover on a key person are dependent on the needs and business model of the individual firm. In the worst case scenario where the key person is not able to return to work, then the needs may be similar to those identified earlier in the chapter in terms of considering lost revenue and the costs of recruiting and training a replacement.

Where the key person is able to return to work, then the costs involved may turn out to be lower; for example, the cost of hiring a short-term replacement on a contract basis. However, when taking out cover for a broad range of conditions, it can be difficult to know the likelihood of the key person being able to return to work should a claim need to be made. Therefore, firms may find it prudent to budget on a 'worse case scenario' basis.

6.4 Life and Earlier Critical Illness

As previously mentioned, CIC can be added to a term insurance policy, thus providing protection from death as well as from contracting a critical illness.

Example

Lucas and Pia are married and have recently had a child, Chloe, who is now six months old.

Pia took maternity leave from her job, and at the same time, Lucas made the decision to become self-employed; this was to increase flexibility so he could spend more time with Chloe.

Pia was recently diagnosed with breast cancer.

Cancer is one of the core illnesses covered by critical illness policies.

Fortunately, at the time they took the mortgage out on their home, they were advised to include CIC on the life insurance policy. As a result, Lucas and Pia have received a tax-free lump sum of £100,000 from the policy. This paid off the outstanding mortgage, leaving them with spare funds.

Lucas was able to delay his plans for the business to help look after the baby, the home and Pia.

If they had not taken out the life, and earlier CIC, policy, Lucas and Pia's situation could have looked quite different.

As critical illness insurance cover pays out only when an illness or an event specifically listed in the policy happens, it is vital to get the most comprehensive policy possible. A basic plan is normally the cheapest and can cover the most common critical conditions, ie, stroke, heart attack and cancer; a comprehensive plan, however, covers many more conditions, including loss of sight or hearing, and total permanent disability.

It is vital when taking out CIC to disclose all health conditions, past and present.

Critical illness policies usually contain certain exclusions; these can vary between insurance companies and will be listed in their key features documents (KFDs).

The most common exclusions are:

- aviation
- criminal acts committed by the life insured
- drug abuse
- failure to follow medical advice
- hazardous sports and pastimes
- living abroad
- self-inflicted injury, and
- war and civil commotion.

Some insurance companies allow the policyholder to increase the level of cover annually to keep up with inflation; the premium will increase accordingly. The policyholder is notified in advance, and may decline the increase.

The insurance company may also allow the policyholder to increase the cover on the occurrence of certain specified events – for example, marriage or civil partnership, or having a child – without providing further medical evidence. This is known as 'guaranteed insurability', and is normally restricted to a percentage of the existing cover. On taking up this option, the premium will also increase in line with the increased cover.

In addition, some policies also provide a level of benefit in the event of a child of the policyholder being diagnosed with a critical illness; this does not usually reduce the level of critical illness benefit payable should the life insured need to make a claim.

Other insurance companies may allow an increase in cover at any time, but the policyholder will generally need to provide up-to-date health information to enable them to make a decision.

6.5 Cost

The premium amount depends on the applicant's age, health, occupation, smoking status, the amount and type of cover, and how long the policy is to last.

If the policy is reviewable, then the premiums will increase over time. A guaranteed policy ensures that the premium never increases during the term.

7. Long-Term Care Planning

Learning Objective

2.7.1 Know the range, structure and application of long-term care insurance to meet financial protection needs including: political environment, social care policy, national factors

2.7.2 Know the main product types and features

2.7.3 Be able to evaluate long-term care protection taking into account cost, resources and appropriate options

2.7.4 Understand factors relating to: immediate needs provision; long-term care planning process

2.7.5 Know legal considerations relating to vulnerable clients: the Mental Capacity Act 2005 definition of capacity; lasting power of attorney and the different types; deputy of the Court of Protection

2.7.6 Understand the regulatory considerations that apply to long-term care insurance: Financial Conduct Authority's (FCA's) 'packaged product'/retail investment products regime; roles of Financial Ombudsman Service (FOS) and Financial Services Compensation Scheme (FSCS); provision of pre- and post-sales information; claims handling rules

2.9.6 Be able to analyse estate planning and its application in the financial planning process: the basics of wills and will planning; the events that invalidate wills; laws of intestacy; importance of regular reviews; use of lasting powers of attorney

7.1 Political Environment

The Care Act 2014 resulted in fundamental changes to the care system. The Act set out the responsibilities of local authorities to ensure that people receive the services they need, can get information and advice to make decisions about care and support, and to provide the appropriate services for those people to choose from. The aim of the Act was to encourage independence and well-being and give greater control and influence to those in need of support.

To determine whether someone needs care and support, the local authority must carry out an assessment of that person's need for care and support, as well as an assessment of a carer's need for support.

Once the assessment has been carried out, the local authority can determine whether that individual is eligible.

If, after the assessment, the individual has not met the eligibility criteria, the local authority must make available written advice and information about where else they could get help from; this might include charities or other local organisations.

If a person is eligible, then the local authority must work with them, their carer and others interested in their welfare to prepare a care and support plan (or a support plan for carers), and help the person decide how they are going to have their needs met.

The steps of the assessment process are as follows:

- The local authority does a care needs assessment to identify what help is needed.
- The care plan sets out recommendations and whether or not residential care is required.
- A personal budget is calculated to assess the cost of the care.
- A financial assessment is carried out to work out how much the individual should pay towards care costs and how much the local authority will cover.

The financial assessment is a means test and will consider:

- income
- savings
- investments
- state benefits or other financial support, and
- expenses, eg, paying bills or rent.

There are no fixed rules for working out how much a person should contribute as all local authorities operate different means test systems.

A person will generally have to pay for the full cost of care if their 'capital' (savings or investments) is more than a set amount. At the time of writing, the thresholds were as follows:

- £23,250 in England or Northern Ireland
- £24,000 (if care is at home) or £50,000 (if care is in a care home) in Wales
- £35,000 in Scotland.

Capital of less than £14,250 (in England) is disregarded for charging purposes. However, if the amount of capital is between £14,250 and £23,250, the level of contribution to care costs is determined by allocating an income value of £1 for every £250 of capital.

Certain capital is partly or fully disregarded in the financial assessment; for example, investment bonds are disregarded. There may be a temporary disregard for personal injury payments. Personal possessions are disregarded unless they were bought with the intention of avoiding residential care charges.

Sometimes, capital can be included even if the person does not have any; for example, an unclaimed prize. Deliberate deprivation of assets will result in the possible inclusion in the calculation.

Some of an individual's income may be disregarded. For example, the mobility components of personal independence payments, attendance allowance and personal independence payment.

The person's income in a financial assessment is looked at on a weekly basis to assess how much the local authority should contribute to care fee costs.

When income is assessed for care, each person is given a personal expenses allowance (PEA).

The PEA is the minimum amount of income allowance that individuals are allowed to keep when in social care to pay for:

- personal items
- newspapers
- treats, and
- toiletries.

This is technically deducted from any assessed income.

7.2 State Assistance

State assistance can help pay fees, but it is limited. For example, there is an attendance allowance, a payment of £73.90 (lower rate) or £110.40 (higher rate) per week (in 2025–26), which is payable tax free and can help with extra costs for those with a disability severe enough to need personal support.

If a person has a disability or complex medical problem, they might qualify for financial support from the National Health Service (NHS) continuing healthcare (CHC) service; as part of the financial assessment, the individual will be assessed for CHC. The actual amount is dependent on where the person lives in the UK and is paid directly to the care home to offset against fees.

Homeowners with savings below the £23,250 threshold can claim a 12-week property disregard where the value of the property is excluded from the financial assessment; this could mean the ability to access some state funding for this limited period.

Assets which fall below a lower limit (£21,500 in Scotland, £14,250 in England and Northern Ireland, and £24,000 in Wales at the time of writing) are ignored. Normally, the individual will pay £1 a week for each £250 of assets between the lower and upper limits. Also, they will have to pay any occupational pension plus their state pension to the council (as well as any benefits they may receive). They are allowed to keep £30.65 a week (£43.90 in Wales, £34.50 in Scotland, £30.44 Northern Ireland) for personal expenses.

7.2.1 Paying for Care

As mentioned, state benefits are limited, particularly where homeowners are involved and, owing to the fees involved in long-term or nursing care, pension benefits will not be enough for many individuals to fund their care.

With any jointly held assets, the local authority will include 50% of these in assessing the assets for the person needing care. For financial planning purposes, therefore, it can be better to hold assets in separate names as far as possible.

Many believe that homeowners could be forced to sell their properties in order to fund care. This may not actually be the case; however, if there is no other method for funding care, the local authority may take legal action to gain funding for a vulnerable person requiring care.

If the client wishes to keep the property and no other savings are available, there are other options such as letting out the property to generate income. However, this is taxable and is often not sufficient to cover the funding shortfall, in which case additional income must be found.

The local authority deferred payment scheme may be able to help, and will pay towards care in return for an interest-free charge against the property that must be repaid on death. The property may still have to be sold to repay the debt.

If a property is sold, or if there are other savings available, there are a number of options that could be utilised. The options vary, the simplest being keeping the funds in interest-bearing cash accounts and gradually spending the capital. In a low interest rate but inflationary environment; however, the risk that the funds become depleted to a level that the current care home becomes no longer affordable is ever present.

Alternatively, in exchange for a lump sum payment, a care fee **annuity** may provide a sufficient guaranteed tax-free income for life. This should help ensure that fees can be met for life and also protect any remaining capital. The risk here is that no capital is returned on death.

7.3 Long-Term Care Insurance (LTCI)

There are two types of long-term care insurance (LTCI), namely:

- **immediate care LTCI** – this can be purchased at the time the client actually requires the care, and
- **pre-funded LTCI** – purchased in advance, and only used should care be needed in the future.

Pre-funded long-term care plans are not currently being offered by any provider in the UK market. However, some clients may have existing plans which are still in force.

7.3.1 Immediate Care LTCI

This can be purchased at any age and at the point of care being required.

The immediate care plan is purchased with a lump sum, and pays a regular income until death; this income pays for the care provision, and is tax-free if it is paid direct to the care home.

The premium paid depends on:

- the amount of income required
- if income is required to increase; for example, with inflation
- the age of the client, and
- the client's health.

The individual will be assessed medically to determine how much they must pay for their chosen level of income.

7.3.2 Pre-Funded LTCI

Currently there are no pre-paid plans available in the market; however, you may come across clients with existing plans.

These plans could have been bought in advance at any age, but some polices impose a minimum age of 40 or 50 for receiving benefits.

The policy will pay out a regular sum if care is needed. It starts when the client is no longer able to perform a number of activities of daily living (ADLs), such as washing, dressing or feeding without help; or because of mental incapacity. The benefits paid out are tax free.

Some existing policies may be linked to an investment bond, with the intention that withdrawals can be taken from the bond to fund the premiums on the insurance policy. These policies involve more investment risk and, in some cases, can use up the client's capital.

Payments for the policy can be regular monthly premiums or a single lump sum premium. In either case, the insurance company usually reviews the plan every five years or so and the premiums may then rise, even in the case of single premium policies.

7.3.3 Deprivation of Assets

As already mentioned, in order to qualify for free care, an individual cannot have assets over certain limits which vary depending on where in the UK the person lives. If they have assets above the limit, then they must pay for their care in full and use personal assets to do so.

It may be tempting, therefore, to gift property or savings to someone else in order to qualify for financial help from the local authority. As you can imagine, this is prohibited and the local authority can, when assessing someone's eligibility for funding, look for evidence of deliberate or intentional deprivation of capital.

Deliberate deprivation occurs when someone transfers an asset in order to put themselves in a better position to obtain funding.

If the local council believes that this has occurred, it may try to claim the care fees back. However, good planning in advance – while the person is in good health – can help to mitigate these issues, eg, a couple holding assets in separate names.

7.3.4 The Mental Capacity Act (MCA) 2005

The Mental Capacity Act (MCA) 2005 has been in force since 2007 and covers people in England and Wales who have lost mental capacity and cannot make decisions for themselves. It applies to anyone involved in the care of those over the age of 16.

The Act is designed to protect vulnerable people who lack capacity, and all professionals involved in care must comply with the Code of Practice.

The Act is underpinned by five key principles:

1. **A presumption of capacity** – unless proved otherwise.
2. **Individuals being supported to make their own decisions.**
3. **Unwise decisions** – people have the right to make decisions that others may regard as unwise.
4. **Best interests** – anything done for a person lacking capacity must be in their best interests.
5. **Less restrictive option** – act in a way that would least interfere with rights and freedom.

7.3.5 The Office of the Public Guardian (OPG)

The Office of the Public Guardian (OPG) helps people in England and Wales to stay in control of decisions about their health and finance and, make important decisions for others who cannot decide for themselves.

The OPG supports the legal functions of the MCA 2005 by protecting people in England and Wales who may not have the mental capacity to make certain decisions for themselves, such as regarding their health and finance.

They are responsible for:

- taking action where there are concerns about an attorney or deputy
- registering lasting and enduring powers of attorney
- maintaining the public register of deputies and people who have been given lasting and enduring powers of attorney
- supervising deputies appointed by the Court of Protection and making sure they carry out their work in line with the MCA, and
- looking into reports of abuse against registered attorneys or deputies.

7.4 The Court of Protection

The Court of Protection makes decisions on financial or welfare matters for people who cannot make decisions for themselves because they lack mental capacity.

The Court of Protection is responsible for:

- deciding whether someone has the mental capacity to make a particular decision for themselves
- appointing deputies to make ongoing decisions for people who lack mental capacity
- giving people permission to make one-off decisions on behalf of someone else who lacks mental capacity
- handling urgent or emergency applications where a decision must be made on behalf of someone else without delay
- making decisions about a lasting power of attorney or enduring power of attorney and considering any objections to their registration
- considering applications to make statutory wills or gifts, and
- making decisions about when someone can be deprived of their liberty under the MCA 2005.

7.4.1 Court of Protection Deputy

An application can be made to the Court of Protection to become someone's deputy if they lack mental capacity.

People may lack mental capacity because they have, for example:

- had a serious brain injury or illness
- dementia, or
- severe learning disabilities.

A deputy can be authorised by the Court of Protection to make decisions on their behalf.

7.4.2 Types of Deputy

There are two types of deputy:

- a property and financial affairs deputy, and
- a personal welfare deputy.

Deputies are usually close relatives or friends of the person who needs help making decisions and must be aged 18 or over.

7.5 Powers of Attorney

An important part of financial planning is thinking ahead; setting up a power of attorney to make decisions on someone else's behalf should mental capacity be lost is a sensible step to take whatever the age or health of the person. The person who puts in place a power of attorney is called the 'donor'.

7.5.1 Types of Power of Attorney

Ordinary Power of Attorney (OPA)

This is created for a defined period and can be useful to have in place if the donor is going overseas and wants someone to have the authority to act on their behalf. The authority can be general or limited to a specific thing. It will normally come to an end either at a set time or by the request of the donor. It will also automatically be revoked if the donor loses mental capacity.

Lasting Power of Attorney (LPA)

This was introduced by the MCA 2005 on 1 October 2007, and replaced the enduring power of attorney (EPA).

There are two types of LPA:

- a property and financial affairs LPA, and
- a health and welfare LPA.

An LPA must be signed by the donor (the person giving the power) and the attorney(s) in the presence of an independent certificate provider. The role of the certificate provide is to confirm that the donor understands what they are doing and is not being pressured to sign the document. The certificate provider must not be:

- under the age of 18
- a member of the donor or attorney's family
- a business partner or paid employee of either donor or attorney
- the attorney, or
- the owner, director, manager or an employee of a care home in which the donor lives, or a member of their family.

The signatures of both donor (the person giving the power) and attorney must be witnessed by a third party, who must be over the age of 18 and cannot be an attorney or replacement attorney. The witness may be the certificate provider.

The power may also name one or more replacement attorneys, people who will act if the original named attorney(s) are unable, for example because they themselves have passed away, or become mentally incapable.

LPAs are often put in place when arranging a will with a solicitor. However, they can also be arranged by the donor by downloading the forms from the OPG website.

Up to five people can be informed when the LPA is registered. There is a separate form (LP3) which can be used by the person who is registering the LPA to notify those listed that the LPA is being sent for registration. This ensures that trusted individuals, who are separate from the attorneys, are informed that the donor's affairs are to be taken over by someone else if the donor becomes incapable. They have the power to object.

Enduring Power of Attorney (EPA)

An EPA made before 1 October 2007 continues to be valid, even if it was registered after that date. An EPA comes into effect as soon as it is made and enables an individual to appoint an attorney to look after their property and financial affairs on their behalf. It is only registered with the OPG when the donor is unable to act for themselves which could result in a delay, thus leaving the client in a vulnerable position. An EPA cannot be changed; it can only be cancelled, or replaced with an LPA.

Attorneys have to act in the donor's best interests; they can be guided by the donor's wishes but do not have to be bound by them.

7.5.2 Setting up a New LPA

Any number of attorneys can be appointed. The donor chooses whether any of them can act separately, known as 'jointly and severally', or if they have to agree and act together, known as 'jointly'.

The donor can decide to allow them to act separately on some things but together on others. The general advice is to keep matters simple and consistent: jointly and severally is better, so that any of them can act independently.

There are two separate types of LPA: property and financial affairs, and health and welfare. The donor can make one or both; but because each type has very different purposes it is normal to do both.

Each LPA has to be registered separately. The property and financial affairs LPA can be used as soon as it is registered; the health and welfare LPA can only be used once the donor loses capacity to make decisions.

A property and affairs LPA gives the attorneys powers to manage the donor's money and property, for example, managing a bank account, paying bills, arranging benefits or selling a home. Restrictions can be imposed on the attorney's powers, for example it could prevent them from selling a second home which the donor has already bequeathed in a will.

If the donor has a partner, it is advisable to hold bank accounts and investments in separate names, as any joint accounts will be frozen when either party loses capacity until the power of attorney is fully enacted.

The donor has the choice to state whether they wish any attorneys to act before any loss of capacity or only after that. Some people are happy for an attorney they trust (for example, a relative) to take over their financial affairs at an earlier stage.

If a person giving an LPA wants to include the use of a discretionary investment manager to manage their investments, then the LPA must specifically include that power.

A health and welfare LPA allows the attorney to make decisions about medical care, moving into a care home and life-sustaining treatment. The LPA form must have clear instructions on whether any attorneys can make life-or-death decisions about the donor's medical care.

Again, limits may be set, such as religious considerations relating to medical treatments. Any such requirements, also known as advance decisions to refuse treatment, must be separately signed and witnessed. Personal welfare LPAs are like living wills but they have the force of law and cannot normally be amended in any way by attorneys themselves, or by relatives or doctors.

7.6 Equity Release

Equity release is a way of accessing money tied up in a person's home. For many people their home is the single biggest asset they own and with a shortfall in pension provision, offers a way to generate more income. However, there are strict rules as to how this can be done and, generally, it is available to those aged 55 and over.

There are two main types of scheme:

- lifetime mortgages, and
- home reversion plans.

7.6.1 Lifetime Mortgages

A lifetime mortgage is a loan secured against the value of someone's home; the home is not sold and the owner retains complete ownership and the right to stay there.

Interest is charged at a fixed rate and can be either of the following:

- **An interest roll-up mortgage** – this is where interest is added to the loan. This means there are no regular payments as the amount borrowed, including the rolled-up interest, is repaid at the end of the mortgage term when the home is sold.
- **An interest-paying mortgage** – the individual receives a lump sum and makes either monthly or ad hoc payments. This reduces, or stops, the impact of interest roll up. Some plans also allow the individual to pay off capital should they so wish. The amount borrowed is repaid when the home is sold at the end of the mortgage term.

When the individual dies or moves into long-term care, the home is sold and the loan is repaid; anything remaining goes to the individual's beneficiaries. If the estate is able to pay off the mortgage without having to sell the property, they can do so. If there is not enough money left from the sale, the beneficiaries would have to repay any extra above the value of the home from the estate.

To guard against this, most lifetime mortgages offer a 'no negative equity' guarantee. With this guarantee the lender promises that the individual (or their beneficiaries) will never have to pay back more than the value of the home. This is the case even if the debt has become larger than the property value, and is in fact included in the Code of Conduct of the Equity Release Council which represents equity release providers.

Advantages

- Money can be released as a guaranteed monthly income or as a lump sum.
- The individual can stay in their home for as long as needed.
- The loan is only repaid on death or on the sale of the property.
- There is the potential to benefit from any future increases in the value of the property.
- Fixed-interest rates prevent the impact of interest spiralling out of control.
- Many schemes guarantee that the total debt cannot exceed the value of the property.
- When the property is sold, and the debt paid off, there might be some money left over for beneficiaries.
- The equity released is tax free and can help to reduce IHT.

Disadvantages

- Benefits or local authority support may be affected.
- Any inheritance is reduced and may be extinguished.
- Inflexible if circumstances change.
- The lender's permission may be required if a relative, carer or new partner moves in.
- The borrower may need to pay arrangement, valuation and legal fees.
- The lender may not allow the transfer of the debt to a smaller property.
- Buildings insurance will still be necessary, as will home maintenance.

7.6.2 Home Reversion Schemes

Home Reversion Scheme

A home reversion scheme is similar to a lifetime mortgage but, instead of borrowing money and being charged interest, part or all of the property is sold.

The sale is made at less than current market value in return for a tax-free lump sum, a regular income, or both, and the seller remains in the home as a tenant, paying no rent.

When the home is eventually sold, the reversion company gets their share of the proceeds of the sale.

As with lifetime mortgages, there are both advantages and disadvantages.

Advantages

- The individual can stay in their home for the rest of their life or until they move into a care home.
- The equity released is tax free.
- There are no interest charges.
- It can help to reduce any potential IHT liability.
- Only part of the property needs to be sold, leaving the rest towards an inheritance.
- The capital raised could buy an immediate needs annuity for regular income.

Disadvantages

- The minimum age of 55 is higher than other equity release schemes, in general.
- The increase in income/capital could affect entitlement to benefits or local authority support.
- Any inheritance will be reduced and will not include the part of the home sold.
- The home is sold for considerably less than its full market value.
- If the plan is finished early and the individual needs to buy back the share sold at full market value the price could be a lot more than it was sold for.
- Likely to be poor value if the person dies early, although some schemes give families a rebate in the first few years.
- Can be inflexible if circumstances change. Not all equity release schemes are portable from one home to another and an individual will usually need the provider's permission for someone else, such as a relative, carer or new partner, to move in.
- The seller will still have to keep the buildings insured and the home in good condition.

7.6.3 Home Income Plans

Although no longer available, a home income plan works by allowing a property owner to release equity tied up in their home. The equity released is then used to buy an annuity which pays a monthly amount for life.

Part of the annuity payment is used to pay the interest on the loan, and the remainder can be used as an income. The original loan is repaid when the property is sold, or the owner moves into a care home.

The amount of money that can be released from a property is determined by annuity rates. For a home income plan to be feasible, it must provide enough to cover both the interest as well as a monthly

income, so for most people this may mean releasing a large proportion of the equity. Because annuity rates are so low, home income plans are normally only an option for those aged 75 and over.

Example

A number of years ago, Christine wanted to release some money from her property to give a monthly boost to her pension income.

- She released £45,000 using a home income plan with an interest rate of 6.5%.
- The £45,000 was used to buy an annuity, with the first £243.75 of each monthly income instalment paying the interest on the mortgage.
- Christine received the balance of around £200 every month.
- She died ten years later; the house was sold, the lender was repaid the loan amount of £45,000, and the equity balance was paid to Christine's estate.

Note that over the ten-year period Christine paid around £29,200 of interest.

Advantages

- Regular income for life.
- The original loan does not get higher.

Disadvantages

- Annuity rates may be low at the time or they may be fixed so inflation will erode the value of the income.
- The annuity bought may not be the best available rate.
- Means-tested state benefits may be affected by the additional income.
- Many providers will not lend against warden-assisted sheltered housing or retirement flats.
- Early repayment penalties.

7.7 Regulatory Considerations

7.7.1 The Financial Services and Markets Act 2000 (FSMA)

As a result of changing demographics, increased life expectancy, spending longer in retirement and diminishing pension returns, long-term care is becoming an increasingly important area of financial planning.

Since 2004, the sale and marketing of all long-term products has been a regulated activity under FSMA 2000, and the Financial Conduct Authority (FCA) regulates all types of long-term care insurance.

Long-term care products have included pure insurance in the past but are no longer available. These products are now typically long-term care investment bonds and immediate needs annuities as these are defined as designated investments under FSMA rules and are subject to full conduct of business (COBS) regulation as **packaged products**; the sale and marketing of these products is also subject to full COBS regulation.

The UK left the EU as of 31 January 2020. On 26 March 2021, the UK and the EU confirmed that technical agreement on a Memorandum of Understanding (MOU) for cooperation on financial services regulation had been reached. It was not clear at the time of writing whether the UK would be granted 'equivalence' – access to EU markets granted to countries whose regulations are deemed sufficiently similar to the EU's own.

Training and Competence (T&C)

In order to be able to give comprehensive and reliable advice, LTCI advisers (and their supervisors) are subject to enhanced T&C requirements. They need specialised knowledge of the complexity and variety of products available, the interaction with state benefits, relevant laws (including inheritance and tax laws), and care costs and provision.

It is a regulatory requirement that any adviser wishing to provide advice on long-term care must hold an appropriate qualification.

Claims Handling

Claimants are, in general, likely to be in poor health and they may be represented by a third party. Prompt and sensitive handling of claims on pre-funded policies is, therefore, particularly important.

When dealing with LTCI claims, companies should aim to agree and meet each valid claim as soon as possible. If a claim is not regarded as valid, the company should inform the client without delay. Companies should conduct all necessary claims processes in a sensitive manner, taking into account the circumstances in which the claim for benefits arises. Employees and company agents should respect the dignity of the client at all times.

Companies will provide an appeals procedure for use in the event that there is any dispute with a policyholder over the validity of a claim for benefit. Wherever possible, companies will aim to resolve any dispute in relation to a new claim before the time at which the client believes benefit payments should commence. Where any dispute arises in relation to continued entitlement to benefits which are already being paid, the company should provide at least one month's notice of any withdrawal of benefit.

Information about dispute and appeal procedures will be provided in relevant printed materials relating to LTCI, including the KFDs. This will contain information sufficient for the client to identify the person who is responsible for making decisions on the validity or otherwise of claims on the policy. These details, including details of the Financial Ombudsman Service (FOS) (see section 7.7.2), will be brought to the client's attention separately in the event of any dispute, or potential dispute, arising.

Convertible Products

The FCA ensures that convertible products (such as critical illness and income protection) which can provide a long-term care option at a later stage are protected, but where these are structured as two separate contracts and conversion is optional, the requirement for the adviser selling the first contract to be LTCI-qualified has been removed.

7.7.2 Financial Ombudsman Service (FOS)

The FOS is an independent free service that deals with complaints from customers regarding financial institutions.

Customers should first take their complaint to the institution involved. Following this, if the customer is not satisfied with the outcome, the matter can be referred to the FOS.

A complaint can be referred to the FOS within the later of the following:

- six years of the event complained about, or
- three years after the complainant knew, or should have known, that they had cause for complaint.

The complaint must also be referred within six months of the date of the institution issuing its final decision letter.

Where these timescales are not met, the institution may object to FOS consideration of the complaint on the grounds that it is considered to be 'time barred'.

Exceptionally the FOS will Deal with a Complaint Beyond these Timescales

The maximum financial award the FOS can make is currently £430,000 for complaints referred to the Ombudsman on or after 1 April 2024 about acts or omissions by firms on or after 1 April 2019. If the referral is on or after 1 April 2024, but the complaint relates to an act or omission prior to 1 April 2019 then the limit is £195,000. The limit is adjusted each year in line with inflation as measured by the Consumer Price Index (CPI).

7.7.3 Financial Services Compensation Scheme (FSCS)

The FSCS protects consumers of UK-authorised financial services firms by compensating them if a firm has stopped trading or does not have sufficient assets to meet claims.

The compensation limits are as follows:

Investment firm or home finance firm	100% up to £85,000
Bank, building society or credit union	100% up to £85,000
General insurance	90% of the claim with no upper limit
Long-term insurance (life insurance, pensions and annuities)	100% of the claim with no upper limit

For bank and building society accounts, joint account holders are entitled to 100% of the compensation limit each, ie, a total of £170,000.

A temporary limit of £1 million also applies in certain circumstances where account holders have a temporary high balance. Examples include recipients of an inheritance, insurance payout or property sale. This increased limit applies for a maximum period of six months from the date the funds are received into the account.

8. Insurance-Based Protection

Learning Objective

2.8.1 Be able to analyse the main features of personal accident, sickness insurance and unemployment insurance

2.8.2 Be able to analyse the main features of private medical insurance, hospital plans and dental insurance

2.8.3 Be able to analyse the main features of payment protection insurance – mortgage, credit

8.1 Personal Accident and Sickness Insurance

This type of insurance pays a cash benefit if the life insured has an accident and is either injured or dies. There are various policies available but most will pay out if the life insured:

- dies
- is permanently disabled, or
- loses a limb.

Some will also cover hospitalisation costs, while others will provide a weekly benefit paid if the life insured is unable to work due to illness or accident; this benefit is usually paid for a limited amount of time of either one or two years.

8.2 Private Medical Insurance (PMI)

PMI is an insurance policy designed to cover, in full or in part, the cost of private medical care for illnesses which are short term and curable. It can be bought individually, or is often provided to employees by their employers.

PMI plans general fall into the following categories:

- budget
- standard, and
- comprehensive.

Budget plans will tend to have low costs, high excesses and limits on cover whereas comprehensive plans are the most costly and provide the fullest cover.

The premium can be reduced by paying an excess where the insured person pays the first part of treatment. The higher the amount of excess, the cheaper the premium. An alternative can be a 'shared risk' plan, where the insurer pays up to a specified level and the insured person pays the rest.

Policies can be underwritten, or they can be accepted without being underwritten, but subject to a moratorium. This means that pre-existing medical conditions will not be covered; sometimes this is based on a minimum time period, such as two years. It does mean that the contract can be set up quickly but also means that underwriting is simply delayed until the claim stage.

Uses

- For anyone who would like more control over the timing of medical procedures for acute illnesses.
- For those who prefer private healthcare facilities, as opposed to state-funded facilities.
- For those not entitled to treatment under the NHS.

8.3 Hospital Plans

This type of policy is designed to provide a tax-free cash benefit if the policyholder needs treatment either as a hospital inpatient or outpatient (caused by a covered accident/illness/disease).

Many plans provide cover up to the age of 65 (assuming premiums are paid), but it needs to be reviewed regularly to make sure it remains adequate for the policyholder's needs.

Typically, premiums are payable monthly; if a premium is not paid on the due date, cover will stop unless the premium is received within 30 days.

Inpatient benefit is usually a payment of a fixed sum (set in the policy) for each night spent in hospital.

Outpatient benefit is for scheduled visits to a hospital as an outpatient for a reason covered by the policy.

Recuperation benefits may also be included, for example, on being discharged from hospital after being an inpatient.

8.4 Dental Insurance

Most people have to contribute towards the cost of dental treatment, and PMI does not necessarily cover it; if it does so, the cover is probably limited. There may be restrictions on amounts paid or what is covered, or possibly a total exclusion (especially if there has been no regular dental check-up).

8.4.1 Dental Plans

These tend not to be standard but each insurer will offer different policies and cover; some will offer choices as to what is covered.

In a dental plan, the normal rules covering health insurance tend to apply. Some policies are called NHS cover (ie, they only cover the costs of NHS treatment). However, many will cover the costs of private treatment. The main aim of dental insurance/a dental plan is to offer cover for preventative and/or minor/major restorative dental treatments; however, they will set limits to costs and types of cover. Some plans can offer cover for dental emergencies and accidents anywhere in the world.

8.4.2 Restrictions

Most UK providers only offer cover if the patient has good teeth to start with, and no work that needs doing. They may even demand regular visits to a dentist.

Normally they will not cover:

- cosmetic treatments
- orthodontic treatments
- dental implants, or
- sports injuries, unless a mouthguard is worn.

8.5 Unemployment Insurance

Unemployment insurance is often sold as a rider to accident and sickness cover. This basically means that it is an optional add-on to a policy which is primarily designed to cover a different risk. However, it can be purchased as a stand-alone policy in its own right. It is designed to pay out where the holder finds themselves out of work through no fault of their own.

For a normally employed individual, this would generally cover a situation where the policyholder's role was made redundant and an alternative position was not able to be offered. Typically, the individual must have been employed continuously by the same company for the last 12 months on a permanent contract. Some policies also provide cover for the self-employed but, on most, this is limited or non-existent.

Payment on unemployment insurance is usually conditional on the claimant being registered with the local job centre. They may also need to be in receipt of related benefits such as universal credit or employment & support allowance. Payments are made for a limited period of time only, typically a maximum of one or two years.

Like all insurance, unemployment policies will generally include a number of exclusions or conditions that will prevent a claim on the policy, for example, being employed on a temporary or contract basis, or if the individual was aware that they may become unemployed when taking out the policy.

The insurance will not pay out where the claimant has left their job voluntarily, nor where the role was terminated for reasons related to their own misconduct.

The huge rise in unemployment as a result of the Covid-19 pandemic means that new policies were virtually impossible to obtain at the time of writing.

8.6 Payment Protection Insurance (PPI)

Payment protection insurance (PPI) is a type of accident, sickness and unemployment insurance designed to protect monthly repayments on a mortgage, loan or overdraft if a client is unable to work for any of those reasons.

If the insurance for any of these products contains life insurance, then the cover will generally pay off the balance of the debt covered if the client dies. If the claim is for disability, the monthly repayments may be paid to the end of the life of the loan. Unemployment payments are only made for a fixed period of time; usually either one or two years, and usually after a short deferred period of either 30 or 60 days.

PPI was famously sold by banks and other organisations providing credit as an add-on to a loan without fully explaining what it covered or whether it was suitable. This resulted in a mass misselling scandal which led to several high-profile firms and banks being fined by the FCA. As a result, PPI is generally no longer sold, other than as an accompaniment to a mortgage.

After pressure from the industry to bring closure to the matter, the FCA finally set a deadline of 29 August 2019 for dealing with compensation claims.

9. Estate Planning

Learning Objective

2.9.6 Be able to analyse estate planning and its application in the financial planning process: the basics of wills and will planning; the events that invalidate wills; laws of intestacy; importance of regular reviews; use of lasting power of attorney

9.1 The Principles of Estate Planning

In simple terms, estate planning is the process of planning, during a person's lifetime, for the disposal of their assets upon death. Its main purpose is to ensure that the assets pass to their intended beneficiaries in as tax efficient a manner as possible.

Appropriate factors to consider include:

- **Capital and income requirements** – the client should ensure that their own retirement needs are met as a priority and that any estate planning provisions they make will not leave them facing a shortfall.
- **Preferred beneficiaries** – the majority of clients prefer to leave their estate to their own linear descendants. However, we are living through an age where the traditional family model is no longer the default. Increasing numbers of adults are either childless, or may have children with multiple partners and/or multiple marriages. Family disputes are also increasingly playing a role and charitable legacies are becoming increasingly common. With this in mind, planning arrangements, by necessity, are becoming more and more complex.

- **Tax situation** – not all clients will necessarily have a problem with IHT. In recent years, this has become more common due to the growth in stock market values and property prices, combined with a £325,000 threshold which has not increased since April 2009, albeit the introduction of the main residence nil rate band has gone some way towards redressing this. It has been said that IHT is now impacting those of moderate means in addition to the wealthy.
  The introduction from April 2017 of the residence nil rate band has gone some way to alleviate this. The residence nil rate band permits each individual an additional allowance, currently £175,000, on top of the basic nil rate band where a main home is left to a direct descendant. The allowance relates to residential property only and, like the main nil rate band, can be transferred between spouses on first death.
- **Trust planning** – we have already looked at the main types of trust arrangement which are used in financial planning. These are a key part of estate planning exercises. Often, clients may wish to make some provision for certain parties as part of their will, without permitting them complete ownership and control over the funds. At other times, they may wish to withhold total control until a specific age of maturity has been reached.
- **Pensions** – since the pension freedoms in 2015, the estate planning landscape has also changed. Unused flexible benefit pension funds (loosely, money purchase entitlements) can now be left to dependants or nominees on the death of the scheme member and subsequently to further nominees (known as successors). This means that pension funds can effectively be passed down through generations.
  Pension funds are not subject to the IHT regime and are not counted as part of the deceased's estate. In the event of death before the age of 75, subject to a lifetime allowance test, the funds can be taken tax free by the beneficiaries. This makes pensions a potentially very valuable tool and their importance as part of an individual's overall estate planning should be recognised.

9.2 The Laws of Intestacy

The laws of intestacy are a default lawful position intended to apply where a client passes away without having left a will. The legal term for this is dying 'intestate'. In this situation, there is an established order of precedence for distribution of their assets.

If a person does not have a will in place then their estate will be dealt with under the law of intestacy (s46 Administration of Estates Act 1925).

This means a fixed sum from the estate will be due to their surviving spouse and the rest of the estate will then be divided in equal proportions between the spouse, blood-line children and legally adopted children (but excludes step-children).

Since 2023, the statutory amount due to the surviving spouse has been £322,000 along with the personal items belonging to the deceased spouse and an absolute interest in half of the remaining estate.

9.2.1 England and Wales

The order of precedence in England & Wales is as follows:

- **Spouse/civil partner** – a lawful spouse or civil partner will inherit the deceased's personal possessions, plus assets worth up to £322,000.
  If the estate, excluding personal possessions, exceeds £322,000 in value then the spouse will receive the following:
  - the first £322,000 absolutely, and
  - a half of the remainder.

  The other half of the remainder will be shared equally between the deceased's surviving children, or their own offspring if the child predeceased them. Where there are no surviving children or descendants thereof, the whole estate will go to the spouse.

  This does not include unwedded or cohabiting partners, sometimes referred to as the deceased's 'common law' spouse.
- **Children** – as noted above, where there is a surviving spouse, the children will be entitled to one half of the excess value of the estate above £322,000.

  Where there is no surviving spouse, the estate will be shared equally between the children of the deceased. This includes legally adopted children, but not, for example, step or foster children.

  Where a child of the deceased has previously passed away, any subsequent issue, such as a grandchild or great grandchild, will be entitled to inherit in their place.
- **Parents** – should the deceased have passed away unmarried, with no linear descendants, then any surviving parent will be entitled to the estate. In the event of both parents being alive, they will be entitled to an equal share.
- **Brothers or sisters** – in the event that there are none of the above, the estate will be shared equally between any brothers or sisters. In the event of a brother/sister having previously passed away, any surviving children (nephews or nieces of the deceased) may inherit in their place.

These are followed by:

- half-brothers or sisters (or their children if they have already passed away)
- grandparents
- uncles or aunts (or their children, the cousins of the deceased, if they have already passed away), and
- half-uncles or aunts or their children.

If none of the above can be traced then the deceased's whole estate would become the property of the Crown.

Any minor children will not be entitled to absolute ownership of an inheritance until such a time as they reach the age of 18 or enter into a marriage or civil partnership prior to this age. Until this point, the executor(s) will manage the funds on their behalf.

Example

Albert passes away at the age of 90. He leaves behind a second wife, Jean, aged 85. Albert also has two surviving children, Joseph and Paula, born to his first wife, who predeceased him. Jean was also a widower before they met and had one daughter, Joanna, by her deceased husband. Albert had not left a will at the time of his death. His estate was valued at £500,000.

In this instance, Jean would benefit from personal possessions, plus the first £322,000 of his estate and an absolute interest in £89,000. The other £89,000 (£500,000 - £322,000 - £89,000) would be split evenly between Joseph and Paula. Joanna would not qualify as she was neither his issue, nor lawfully adopted.

9.2.2 Scotland

Under Scottish law, the position is different and can be complicated. Once debts and other liabilities have been paid from the estate, the surviving spouse or civil partner has certain prior rights. This is made up of:

- the rights to a home in which they were resident at the time of the deceased's death to a value of £473,000
- furnishings up to the value of £29,000
- the sum of either £50,000 or £89,000, depending on whether the deceased left children.

Following on from prior rights on the estate come legal rights. Where the deceased left children (or, if already deceased, linear descendants such as grandchildren), they will receive any cash over £50,000 and two thirds of the residual estate, with one third going to the spouse. Where there are no children, the spouse will benefit from £89,000 in cash and half of the remaining estate. The other half is split again, with half going to the parents and the other half split evenly between surviving siblings. If there are no parents, siblings will take the full entitlement and vice-versa. Where there are no surviving children, parents, brothers or sisters, the spouse will be entitled to the entire estate.

Where there is no spouse or civil partner, prior rights do not apply. In this case, the entire estate will be shared between the children or their descendants. Where there are none, the order of priority is parents/siblings equally, aunts/uncles, grandparents, then great aunts/uncles. If none of the above are alive, then unless any other surviving relative can be found, the entire estate will pass to the Crown.

Example

Agnes passed away at the age of 58. She leaves a husband, Peter, aged 60. They have no children yet Agnes' mother, Edna, is still alive. In addition, she leaves one brother, George, who has a family of his own and a sister, Catherine, who is unmarried with no children. Agnes died intestate and her estate was valued at £750,000, including a property worth £400,000 and possessions of £20,000.

Peter would get the property and possessions, plus up to £89,000 in cash. The remainder of the estate would be split into two parts, one half to Agnes' mother and the other half split evenly between her two siblings.

9.2.3 Northern Ireland

The position in Northern Ireland is quite similar to that in England and Wales. A surviving spouse will have first claim, however, they must survive the deceased by at least 28 days.

The spouse will automatically take the first £250,000 plus possessions. The remainder will be split 50/50 between the spouse and child (or, if there are more than one, one third to the spouse and two thirds to the children).

Where there are no children, but surviving parents, the spouse's share is increased to £450,000 plus possessions, with the remainder split evenly between spouse and parents. If the parents are deceased, however, siblings remain, then the spouse receives £450,000, plus possessions, with the remainder split half to the spouse and half in equal shares to the siblings. In the absence of children, parents or siblings, the whole estate will pass to the spouse.

Where the deceased leaves no spouse, children or linear descendants will share the estate evenly. In the event that there is no spouse and no children, the order of precedence is parents, siblings, grandparents, then uncles & aunts. If none of these remain, then the closest blood relative may claim the estate. If no next of kin can be traced, the entire estate will go to the Crown.

9.3 Wills and Will Planning

As we can clearly see based on the above, ensuring that a valid and up-to-date will is in place is a key part of estate planning. The laws of intestacy are inflexible and the writing of a will is a key part of ensuring that the client's assets are left to their preferred recipients in a tax-efficient manner.

9.3.1 Basic Will Planning

There are several key parties to a will:

- **Testator** – the testator is the party whose assets are being disposed of, basically, the person who has made the will.
- **Beneficiaries** – the party or parties who are the recipient(s) of a legacy under the terms of the will.
- **Executor(s)** – the executor of a will is the party charged with ensuring that the assets of the deceased are distributed in accordance with the terms of the will.
- **Solicitor** – it is generally recommended that a will is drafted by a qualified legal professional. This will help to ensure that its validity can be defended in the event of a later challenge.
- **Witnesses** – in England and Wales, the will needs to be signed in the presence of two independent witnesses in order to be valid. The witnesses can be anyone, subject to being over the age of 18 and of sound mind. However, they should not be parties who are also beneficiaries under the will, or the spouse of a beneficiary, as to do so would invalidate their bequest.

On the death of a testator, the executor(s) will need to apply for a Grant of Probate in order to provide them with the lawful right to execute the will. Where the individual died intestate, the equivalent would be a Grant of Letters of Administration. The executor of the estate is responsible for ensuring payment of any IHT that may be due.

Pension funds are treated under a different process. Nominations are made for recipients of the death benefits via an expression of wishes, which is registered with the pension trustees. Technically, this is discretionary, as a legally binding nomination would lead the funds to become part of the chargeable estate for IHT purposes. However, in practice, it would be very rare that a trustee would decline to follow a valid expression of wishes.

9.3.2 Events which Invalidate a Will

There are a number of events which may lead to a previously written will becoming legally invalid. It is, therefore, important that a testator's will is kept under review to ensure that it remains valid and appropriate to their circumstances.

- **Subsequent valid will** – a will is not considered valid if it is not the last will and testament of the deceased. This means that a subsequent valid version, which postdates the original, will be taken to supersede it.

In order to avoid disputes, any updated will should state explicitly that it is the last will and testament of the testator and revokes the previous version(s).

- **Marriage** – the marriage of the testator will automatically revoke any will written prior to that date, unless the will makes clear that it was written in anticipation of the marriage.
- **Death of a beneficiary** – where a beneficiary has passed away since the will was made, in the absence of any updated will, the bequest may be invalidated. While this would not necessarily render the whole will invalid, it could leave parts or all of it open to question.

Example

Matthew, aged 75, passes away unmarried with no children, with an estate valued at £300,000. He had three siblings, Martin, Celia and Carol. Unfortunately, Celia passed away in a car accident a few years prior to Matthew.

- **Scenario 1** – Matthew's will states that he leaves his entire estate in equal shares to his surviving siblings. In this instance, there is no problem, Martin and Carol take £150,000 apiece.
- **Scenario 2** – Matthew's will states that he leaves one third of his estate to Martin, one third to Celia and one third to Carol. Here we may have a problem. Martin and Carol will get their £100,000 apiece, but what happens to the £100,000 earmarked for Celia? The answer depends on the exact terms of the will.
- **Scenario 3** – Celia is Matthew's favourite sibling and the whole estate was left to her. This would effectively invalidate the will. The bequest would not become part of Celia's own estate under UK law.

All of this could have been avoided if Matthew had kept his will up to date.

There are several other sets of circumstances which could lead to either an entire will or a specific bequest being determined to be invalid. These include:

- the will not being properly signed, dated and witnessed
- signs that the will has been altered or tampered with
- signs that it has been made under duress or undue influence
- the testator did not have proper legal capacity when making the will
- the testator not being of sound mind and understanding when making the will
- a will which fails to dispose of all assets could fail in certain circumstances
- any bequest to a beneficiary who is also a witness, or a spouse of, will be considered invalid
- if a dependant is left out without an appropriate clause, this could also be open to challenge.

As we can see, the list is significant and it is, therefore, important that the will is legally watertight.

9.3.3 Deeds of Variation and Disclaimers

On occasion, the beneficiaries of a will may decide mutually that the distribution of assets is not in accordance with their wishes as a collective. This may be the case, for example, where it causes unnecessary tax to be paid, or where recipients have no foreseeable need for the property.

In recognition of this fact, legislation allows for the beneficiaries to complete a Deed of Variation. This means effectively that they mutually agree to alter the terms of the will so that the assets are shared in a different way.

The key requirements under a Deed of Variation are as follows:

- The deed must be signed by all who were beneficiaries under the original will.
- All beneficiaries must be of sound mind and not bankrupt.
- The deed cannot be used to deprive minors of their inheritance.
- The deed must state the property that is to be varied.
- It must state the purpose for which it is to be varied.
- The deed must contain a statement that it is to be treated for IHT purposes as though the deceased had made it.
- The deed must be made within two years of the date of death.
- Each will can only be varied once.
- The deed is not treated as a transfer of value for IHT purposes.

A similar but slightly different document is a Disclaimer. Like the Deed of Variation, this seeks to amend the terms of the original will. In effect, this is completed where one individual recipient disclaims their right to their inheritance under the terms of the will. The bequest then effectively goes back into the 'pot'. Its ultimate destination will depend on the remaining terms of the will.

9.4 Will Trusts

A will trust is effectively a trust arrangement which is established under the terms of a will on the death of the testator. We have already looked at the main types of trust arrangement. A bequest into a trust is treated no differently for IHT purposes than it would have been had the gift been made to a living individual, as the trust is a legal entity.

A will trust may be created, for example, to hold property on behalf of a minor until they reach adulthood, or to allow a beneficiary an interest in the assets for life, with the reversion to a remainderman on death.

This type of arrangement is also sometimes used to avoid 'sideways disinheritance'. This occurs where, for example, a client leaves their full estate to a spouse on death. The spouse then remarries and on death, the full estate is left to the new spouse. To avoid this possibility, the client may prefer to create a trust, allowing a life interest to their spouse, with the assets to revert to the children on death.

9.5 Lifetime Gifting

In order to ensure that estate planning is as effective as possible, it is often advisable to begin disposal of assets prior to death. In addition to the use of wills and trust planning, there are a number of actions which a client may be able to take during their lifetime in order to minimise their eventual inheritance tax liability.

A lifetime gift, whether to an individual or into trust, is known as a potentially exempt transfer (PET) or chargeable lifetime transfer (CLT). On the death of the donor, within three years the gift will be included within the value of the estate for tax purposes.

Its value will then be reduced on a sliding scale as outlined below:

Years	Value of gift for IHT purposes
0–3	100%
3–4	80%
4–5	60%
5–6	40%
6–7	20%

After seven years, the gift will generally fall outside of the taxable estate. However, in the event of further gifting within the seven-year period, a CLT may be relevant for a period of up to 14 years.

In addition to potentially exempt transfers, some lifetime gifts may immediately become non-chargeable for IHT purposes. These include:

- **Annual gift allowance** – this allows up to £3,000 pa to be gifted away and fall outside of the estate immediately. This can be gifted to one individual, or a number of recipients. The allowance can be carried back one year, so that clients who have not previously gifted can utilise up to £6,000 during the current tax year.
- **Gifts to individuals** – this allows an unlimited number of individuals to be made gifts up to £250 per annum apiece. This cannot be used in conjunction with the annual gifting allowance to make gifts above £3,000 to a single individual.

- **Gifts out of disposable income** – gifts of potentially unlimited value can be made to any recipient. This exemption requires that the gifts are made regularly, which could be weekly, monthly or annually for example, and they are made out of disposable income. The value of the gift must be so as not to impact the donor's standard of living.
- **Gifts on marriage** – gifts on marriage to the value of up to £5,000 if coming from a parent, £2,500 from a grandparent or great-grandparent and £1,000 from any other party, will be considered immediately exempt.
- **Gifts for education and maintenance** – these can be made up to any amount, provided only that it is for the education of a child or maintenance of a dependent relative.
- **Gifts to charity** – charitable donations can be made up to any amount during the donor's lifetime or on death with no IHT charge.
- **Gifts to qualifying political parties** – these gifts can be made up to any value, but must become the property of the party. To qualify, a party must hold at least two seats in parliament, or one and 150,000 votes at the most recent general election. Again, these may be made during the donor's lifetime or on death.
- **Gifts for the national benefit** – gifts for the national benefit, for example the National Trust, universities, museums or libraries, can be made as lifetime gifts or on death free of IHT. Again, these have no upper limit.

10. Selecting Appropriate Protection Solutions

Learning Objective

2.9.1 Be able to evaluate the relevant factors for individuals and business clients when it comes to planning their financial protection requirements: priorities, risk and choices; existing arrangements; consequences of inadequate protection

2.9.2 Be able to calculate the current and future capital and income needs in real terms for: family and personal protection; SME business protection needs – business loans, key person, partnership and shareholder protection

2.9.3 Be able to evaluate the relevant factors in selecting appropriate solutions taking account of: similar types of products; client needs; identifying and matching suitable product solutions to needs; combinations of products; current and future affordability; property purchase

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Before making any recommendations, the client's overall position needs to be fully assessed:

- **Quantify their needs** – both income and capital.
- **Gather all the relevant data**.
- **Analyse what they currently have** – this is not just a matter of listing the existing arrangements, they must be analysed to show how far they meet the client's needs.
- **Be careful about recommending replacements** – health may have changed and policies may be more expensive, so they might not be able to obtain the same level of cover. They may need a 'top-up' rather than a replacement.
- **Mention underwriting** – new provider needs to determine if they are insurable and at what rate; existing cover will be taken into account.

10.1 Relevant Factors of Appropriate Solution

Before a client takes out a life insurance or other protection policy, the financial planner should be aware of the following potential gaps in cover:

- **Decreasing cover** – these are policies where the sum insured decreases over the term of the policy. This may be suitable for some clients but not all.
- **Inadequate cover for disability** – even if a policy provides both life and disability cover, the level of disability benefits that can be claimed must be checked, as well as the types of circumstances under which disability cover can be claimed.
- **Inadequate sum insured** – an insurance policy should cover the client's (and their family's) needs, including any outstanding debt.
- **No death benefits** – if the policyholder dies and the beneficiaries begin claims procedures, the insurer may still refuse to pay if the policyholder omitted an important piece of information from their application form. The concept of 'utmost good faith' (*uberrimae fidei*) applies to all forms of insurance and insurers, and may enable insurers to refuse to pay benefits on the grounds that the policyholder was not entirely honest with them.
- **Inaccurate beneficiary information** – if the policyholder fails to update the name of a beneficiary given at the time of purchasing the policy, the wrong beneficiary may benefit or the original beneficiary may have already died so no one is able to claim.
- **Loss of benefits or severe depreciation for one unpaid premium** – it is vital to know the consequences of missing one premium payment. It is possible that the penalty is that beneficiaries could lose death benefits or that these benefits will be significantly reduced after just one missed premium payment.
- **Not enough to retire on** – typical life insurance provides cover in case of death. While the cash value equivalent of such a policy may be withdrawn in full upon maturity or converted to an annuity, this still does not make a life insurance policy a good retirement plan. It is designed to provide the most benefit after death.

A person's needs vary according to their circumstances and will change throughout their life. Family protection incorporates the consideration not just of life cover needs, but also of income protection, critical illness and related areas, such as long-term care and private medical insurance.

The state provides certain financial benefits when a person becomes incapacitated or dies. However, for most individuals and families these benefits will be too low for them to maintain their current standard of living.

There is a clear need for the members of a family responsible for providing the income, or the care of children, to be covered against various circumstances which could reduce or eliminate their ability to continue to provide support to their family.

The death or incapacity of any member of the household who has a responsibility, including spouses who are not engaged in paid work as they look after children, should be considered for protection. If they are unable to care for the children, the result could be that the other partner can no longer work and the family's income will suffer, or they will incur extra expenditure for child care.

Unless the family's financial situation is protected against such eventualities, there is a high risk of a significant reduction in living standards as a result of death or disability.

It is important to find the right type of protection and the right level of cover. A thorough review of the client's personal circumstances will help decide which is most suitable for their family's needs.

Example

Geoff and Jane are aged 36 and 34. They have two young daughters, Sophie aged 8 and Kirsten aged 5. Jane is now expecting a third child and they have recently sold their house for £300,000 and purchased a bigger one for £400,000 in anticipation of the new arrival.

They have a joint life, first death decreasing term assurance policy with a sum assured of £200,000, which was the amount they borrowed to buy their current home. They have no other insurance cover of any nature.

What are their needs? Firstly, with the purchase of the larger home likely to be financed by an increased mortgage, they need to review their protection policy. Specifically, they are likely to require a higher sum assured. Consideration should therefore be given to cancelling the existing policy and taking out a new one.

Let us say that the mortgage outstanding is now £150,000. Then the new policy would need to be taken out for a sum of £250,000, which is the current outstanding debt plus the additional £100,000 as a result of the bigger house purchase.

In certain circumstances, the cost of cover may be significantly higher than it previously was. In that scenario, consideration may be given to retaining the existing policy and simply taking out a top-up policy for the amount of the additional borrowing with a new insurer. However, this is often far from ideal, given that the existing policy was designed to cover the previous mortgage and may not match, for example, the term of the new mortgage or the rate of interest.

Additional needs which their adviser ought to cover with them may be life cover or family income benefit to pay the costs of raising the children in the event of their death or critical illness. They should also consider income protection and/or mortgage payment protection insurance. Depending on affordability, plans such as private medical cover may also be an option, though typically lower down the priority list.

What do you think the consequences might be if Geoff and Jane do not take out adequate protection cover?

Example

Let's go back to our earlier example of Monique, the newly appointed sales manager for Top Class Textiles ltd. Let's say Top Class Textiles' current annual revenue is £1m, which is forecast to grow by 10% per annum for the next five years.

The directors wish to assume that 20% of revenue is driven from clients who are Monique's contacts and would seek a new supplier in the event of her loss. Further, that revenue would remain static over that period rather than increasing as planned. They therefore wish to insure against this possibility.

We need to look at their potential revenues with and without Monique. With Monique, their revenues would be as follows:

Year 1 – £1,000,000
Year 2 – £1,100,000
Year 3 – £1,210,000
Year 4 – £1,331,000
Year 5 – £1,464,100
Total – £6,105,000

Without Monique, the current revenue of £1,000,000 would drop by 20% to £800,000 and remain static for five years, giving a total of £4,000,000. The amount insured would therefore be the difference, ie, £2,105,000.

The calculation method for such cover will always be rather crude as it is very difficult to accurately determine the effect of such an event. However, it is for the business to determine how much risk they are willing to take.

10.2 Planning Process

Discussing death and disability hardly ranks as a favourite activity but failure to plan adequately for the financial consequences involved could mean unnecessary hardship for the client and for their dependants.

Protection should be treated as a financial planning exercise in the same way as retirement and investment planning; it is all about ensuring that the client has sufficient resources to meet their objectives.

The financial planner must properly assess and analyse the client's needs and current provision; otherwise it is impossible to justify the recommendations.

Protection is also for life; it does not end at a client's chosen retirement age, or when a child graduates from university.

10.2.1 Planning Process – Death

What is the financial exposure if an individual dies?

It is tempting to jump right in and start analysing the provision they already have, eg, 'they have a joint life policy that would repay their mortgage'. Forget this for a moment and first set out their actual needs: this will make it much easier to identify where those policies fit in with the overall picture.

10.2.2 Capital Needs

These may be subdivided into separate types:

- Debts/liabilities – does the client have any debts that should be repaid on death: mortgage, credit cards, and other loans?
- Other needs.
- Begin with immediate expenses – such as funeral and legal costs.
- If they have their own business, they may incur other professional expenses to wind it up and sort out tax affairs.
- A contingency sum should also be considered for the survivor in case of unforeseen expenditure.
- What is the total capital required?

10.2.3 Income Needs

Net income required:

- This could be estimated from current outgoings, deducting any that will no longer apply and allowing a percentage reduction for others, such as food and holidays.
- Alternatively, it may be a figure given by the client.
- Are there likely to be any additional outgoings – childcare, housekeeping?
- Is there any planned expenditure in the future – private school and university fees?

Income Available

You now need to consider the net income available to the survivor (if you only know gross income you will have to allow for tax).

Some of these would be immediately available, such as:

- continuing earnings
- payments from life cover (income only, eg, FIB)
- state benefits, and
- a spouse's pension (from an occupational defined benefit scheme).

Others may be available from some future date, such as:

- a state pension
- annuities, and
- an occupational pension.

It is important to see this over the whole of life, not just what is available now. Too often the mistake is made of just considering the income available today, compared with the amount needed, to determine the additional need. However, this does not take into account the income that may become available in later years, and therefore gives a misleading picture of the survivor's financial security. It also fails to take into account the effects of inflation on both income and capital.

Capital Available

- existing life insurance
- death in service benefits
- pension funds
- savings and investments.

10.2.4 Assessing the Need

You are now in a position to assess the real level of cover required:

- Calculate the income shortfall – what capital sum would be needed in order to provide the income required in order to ensure that the survivor is financially secure for the rest of their life?
- Add on the capital needs (such as loans, funeral costs).
- Deduct the capital available.

You now know the sum required in order to provide financial security.

You are then in a position to decide the most appropriate way of providing those funds, whether through a lump sum (eg, term insurance, whole life) or a regular income (FIB), or a combination of both.

10.3 Planning Process – Ill Health/Incapacity

The financial planning process is similar to that of death. The whole purpose is to:

- help the client decide what they would like their financial position to be in such an event (ie, their needs/objectives)
- help them to see their position if such an event occurred today (their 'financial exposure'), and
- recommend the best way of making up any shortfall.

10.3.1 Income Needs

- What net income is required? This could be estimated from current outgoings, deducting any that will no longer apply.
- Alternatively, it may be a figure given by the client, who may be willing to moderate their current lifestyle.
- Are there likely to be any additional outgoings – childcare, housekeeping?
- Is there any planned expenditure in the future – private school and university fees?

10.3.2 Capital Needs

This may be subdivided into separate types:

- Debts/liabilities – do they have any debts that ideally should be repaid: mortgage, credit cards, and other loans?
- Other capital needs – is there any impending or planned expenditure, eg, house refurbishment?
- If they have their own business, they may incur other professional expenses to wind it up and sort out tax affairs.
- A contingency sum should also be considered, in case of unforeseen expenses.
- What is the total capital required?

10.4 Critical Illness

It is important to understand both the purpose and the application of critical illness insurance.

This product is designed to meet a capital need, it is not intended to provide income. This distinguishes it from life insurance, and it means that the level of cover recommended will not be the same.

It will not necessarily pay out at the same time as income protection. Firstly, it is possible to be diagnosed with a serious illness, but not be off work long enough to claim on income protection; conversely, it is conceivable that the individual could be off work and claiming on their income protection policy, without it being one of the critical illnesses.

Secondly, it pays out on diagnosis whereas income protection only pays out if the person is unable to work beyond the deferred period.

For these reasons, it should not be seen as an 'either/or' with income protection.

Recent years have seen a growing trend to recommend CIC alongside life cover for a mortgage. While this is commendable, the recommendations overlook the personal needs that were considered when the product was first launched: for example, adapting a house or car, extra medical and recuperation care, or just a contingency sum for any unforeseen expenses.

Also, mortgage cover tends to decrease in line with the outstanding mortgage, whereas personal needs will rise with inflation.

10.4.1 Income Available

You now need to consider the net income available.

Firstly, the income immediately available includes:

- continuing earnings from a partner or spouse
- payments from own employment, eg, full salary for six months
- any potential state benefits, and
- existing health cover.

Then, the income available from some future date:

- a state pension
- annuities, and
- an occupational pension.

As with planning for death, it is important to see this over the whole of life, not just what is available now – taking into account the income that may become available in later years, and the effects of inflation on both income and capital.

10.4.2 Capital Available

- Existing ill health insurance (critical illness).
- Savings and investments.

The latter is important as you are assessing what the client's 'financial exposure' is if they suffered ill health today, and that means utilising all available resources that they have available. This will demonstrate how long they could manage on those resources, and confirm whether or not they are likely to run out of money. How those resources are utilised will be part of the recommendation.

Once the solutions are decided, they should be checked before recommending to the client:

- Will the recommended policies themselves pay out when required?
- Will the recommended sums insured be sufficient?
- Are the policies affordable and within the client's budget?
- Have trusts been included for life policies where appropriate, so benefits are paid outside the estate and quickly?

Example

Let's consider Geoff and Jane again. Geoff and Jane give their adviser some further details of their income and expenditure. He earns a salary of £40,000 per annum as an IT technician, whereas she is a project manager on £45,000 per annum. Net of 10% pension contributions, his monthly income is £2,375 and hers £2,630.

Current essential expenses including mortgage, council tax, utilities, other bills, insurances, motoring costs and food come to around £3,500 per month. Their mortgage on their current property is for £275,000 over 30 years and comes to £1,300 per month. The previous one was £850 per month, but over a shorter term of 25 years and at a lower rate of interest.

How do we quantify their needs? Right away, they require a new mortgage protection policy to cover the increased borrowing of £75,000. Either lump sum life assurance or family income benefit would be desirable, as would income protection and, in an ideal world, critical illness cover. The cover should take into account their monthly expenditure and the amount required to cover it, including inflationary increases. For family cover, this should be at least until the children (including the new arrival) are old enough to be independent. For personal income protection, ideally until retirement and for mortgage protection, the term of the mortgage.

However, there are practical considerations to take into account. Such as what are they going to do about childcare? The older two children are now in school, but what are they going to do about care for the new arrival? Does one of them need to take a career break, or go part-time, to look after him or her? Do they pay for childcare? Or do their jobs offer sufficient flexibility to work around their childcare responsibilities?

If they have to take a break or pay for childcare, how might this impact the affordability of the proposed protection solutions? Will their income suffice to cover them or do they have savings they could rely on? It may well provide an unfortunate double whammy whereby they have increased protection needs, but significantly less disposable income to pay for them.

10.5 Business Protection

When calculating the future capital and income needs in a business environment, certain factors need to be taken into account such as:

- the effect on profits if a key person died or became seriously ill
- the costs of recruiting a replacement, and
- the loans that could become payable on a key person's death or serious illness.

10.5.1 Business Loans

The amount of the loan will be the sum insured, and the policy would normally be taken out on the key person whose death or incapacity would result in the loan being recalled.

10.5.2 Key Person

When assessing the amount of cover to put in place for a key person, the value of lost profits needs to be considered, as well as the costs of recruiting a replacement. There are two established formulas:

- **Multiple of salary** – this is simply the key person's salary multiplied by an agreed factor which could be as high as ten times.
- **Proportion of profits** – this is often termed a more 'scientific' approach as the formula takes into account the key person's salary, the annual profits and the number of years it would take to replace that key person. The formula is:

$$\frac{\text{Salary x previous year's profit x number of years to replace them}}{\text{Total salary bill}}$$

Example

Connor is the chief designer of an electronics company. The company's total gross profits are £6 million. Connor's salary is £500,000 and the total salary bill for the company is £2.5 million. The company thinks that if anything happened to Connor it would take three years to recover from the loss.

If they took out a life insurance policy to cover this eventuality, using the proportion of profits formula the sum insured would be:

(£500,000 x £6 million x 3) divided by £2.5 million = £3.6 million

10.5.3 Partnership/Shareholder Protection

The purpose of partnership and shareholder protection is to provide the necessary sum of money to buy the shares or business interest from either a partner or a shareholder who is critically ill and wishes to sell, or from their beneficiaries if a partner or a shareholder has died.

The sum insured should, therefore, reflect the market value of that person's interest in the business. This can vary over time so should be regularly reviewed to ensure it remains sufficient.

10.6 Reviewing Protection Needs

Learning Objective

2.9.4 Be able to evaluate appropriate solutions in relation to: cohabitation; marriage; civil partnership; birth of a child; separation and divorce

2.9.5 Be able to evaluate appropriate solutions in relation to: work; going overseas; retirement

While an adviser can put into place protection policies to meet a client's needs, this is not the end of the process. There are a number of situations and life changes which may result in their protection needs and plans needing to be reviewed.

10.6.1 Marriage/Civil Partnership

When a couple get married or enter into a civil partnership their needs can change. Relevant factors that will need addressing include:

- reviewing the will – a marriage will revoke any previous will made unless made in anticipation of the marriage/civil partnership
- increasing the need for life cover
- potentially using the marriage allowance
- reviewing mortgage arrangements, and
- using both ISA allowances.

10.6.2 Birth of a Child

Starting a family should also mean that protection needs to be assessed and reviewed. Relevant factors here include:

- reviewing the will to include guardians while children are minors
- increasing the need for life cover
- claiming of child benefit, and
- reviewing savings/utilising Junior ISAs.

10.6.3 Separation and Divorce

When a marriage comes to an end, financial plans will need reviewing. Relevant factors here include a review of:

- the will (divorce will not invalidate the will, but it will need reviewing because it will revoke the ex-spouse's entitlement)
- protection needs, and
- retirement plans.

10.6.4 Work

The days of a job for life are gone. Nowadays, the majority of people have numerous jobs during their working lifetime as well as possible stages of self-employment, unemployment (voluntary or involuntary) and possible time out to raise families. As employment circumstances change, so too do financial planning needs. Areas which will need to be addressed on changing employment status may include the following:

- Life/incapacity cover.
- Pension contributions.
- Private medical insurance.
- Company/private car provision.

10.6.5 Moving Overseas

As well as this being a major decision, it may also affect existing financial plans. Relevant factors here for consideration include the impact on:

- their UK overseas residences
- any plans held in the UK, eg, ISAs and pensions, and
- retirement plans and estate planning.

10.6.6 Retirement

Relevant factors to consider when someone reaches retirement include:

- ensuring that their will is still up to date
- putting in place a power of attorney
- claiming a state pension
- pension drawdown
- financial security for the survivor if one dies
- estate planning, and
- long-term care planning.

Example

Leanne, aged 35, has just finalised her divorce from her first husband, Glenn. Having no children, she has decided on a clean break and has moved to a new city to be with her new partner, Steve. They have agreed to rent a flat together for the foreseeable future to see how they get on living together. She has resigned from her job with the local government following the move, but intends to look for work in her new city once settled in. As a result of the divorce, she and Glenn sold the marital home. Leanne was allowed to keep the proceeds, which came to £100,000 after expenses, which was offset against Glenn keeping his larger pension entitlement.

Firstly, Leanne needs to consider revising her will, as spouses will often leave everything to each other in the absence of any grown-up children. While a will is usually invalidated if the testator marries, the same is not true if they divorce. Any bequest in favour of Glenn would therefore remain valid until such as time as the will is revoked.

Leanne would usually be well advised to cancel any critical illness cover which may have been taken out to cover her previous mortgage with Glenn. This would no longer be fit for purpose if she does not have a mortgage to protect. However, this type of cover does get more expensive with age and therefore such a plan may be worthwhile leaving in place if there is a realistic likelihood of her and Steve purchasing a home and/or having children.

As an employee of local government, Leanne would have benefitted from the local government pension scheme (LGPS) which is a defined benefit plan and a generous sick pay entitlement. She will therefore also need to consider what her new employer offers in terms of pension entitlement and whether additional contribution on her part is necessary. This is particularly the case since Steve kept all of his entitlement under the terms of the divorce. She will also need to consider whether private income protection is necessary/desirable.

Finally, Leanne now has a lump sum of £100,000 in the bank. Given that the Financial Services Compensation Scheme limit is £85,000 per institution, albeit higher for short-term temporary high balances. However, this also begs the question of what to do with the money longer term. With savings rates very poor and inflation exceeding 9% at the time of writing, it is likely to lose substantial value in real terms.

Leanne could consider placing some or all of the money into fixed rate bonds to seek a better return. If she is unlikely to require access for the longer term (five years plus) then she could consider going into an investment fund. However, if there is the realistic likelihood of her requiring the funds for another property purchase in the foreseeable future then this may not be appropriate.

10.7 Regular Reviews

There is a high chance that a client's circumstances will change many times during the years from starting work, buying a home, getting married, having children, changing career, right through to retirement and death.

Jobs, salary, priorities and commitments are all prone to change and can all affect the client's protection needs and planning. So, it is best to keep on top of changes by reviewing the client's plans on a regular basis.

Example

When you first meet your clients, they are married with one child, they have a mortgage of £120,000, and both work full-time. Five years later, their household income has increased owing to one of them having been promoted, while the other has changed jobs. They are about to move to a larger house and increase their mortgage to £180,000. Will the original income protection policy provide enough cover? Will the life cover set up five years ago be enough to meet their capital and income needs? Do their employers provide any benefits that were not available previously?

It is also important to review the existence of any trust that has been put in place. Pure life policies should generally be written in trust. Not only will the sum insured be outside of the estate for IHT purposes, it also means that the proceeds are paid quickly to the trustees, putting the money in the right hands and at the time that it is most needed. If a life policy has not been written in trust, then it is possible to do this at a later stage.

If a policy has been placed in trust, at a review a financial planner should check that the trustees are still the most relevant people to act as such, and that they are aware of their responsibilities. If a trustee needs to be replaced, this can be done by completing a deed of retirement for the trustee being replaced, and a deed of appointment for the new trustee.

It is extremely important that estate planning arrangements are reviewed on a regular basis to ensure that they are up to date and reflect the wishes of the testator. Certain events can invalidate a will, such as the marriage of the testator. Others, for example, the death of an executor, or a beneficiary under the will, may throw into question the correct parties to execute and/or benefit from a will.

This may mean that the assets are not distributed in accordance with what would have been the wishes of the testator at the time of his or her death. It also raises the possibility of expensive and acrimonious legal action as relatives dispute assets which they consider rightfully theirs.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **What is the fundamental purpose for taking out life insurance for an individual?**
   Answer reference: Section 2.1.2

2. **Which benefits did universal credit replace?**
   Answer reference: Section 3.1

3. **What are the three types of jobseeker's allowance?**
   Answer reference: Section 3.1.3

4. **Which is the least expensive type of life insurance?**
   Answer reference: Section 4.2

5. **What is a family income benefit policy designed to do?**
   Answer reference: Section 4.2.6

6. **What does the term 'tenants in common' mean?**
   Answer reference: Section 4.6.2

7. **Who are the legal owners of trust property?**
   Answer reference: Section 4.6.3

8. **What rate of tax is deemed to have been paid in a life insurance fund?**
   Answer reference: Section 4.8

9. **If an additional rate taxpayer suffers a chargeable event on an onshore investment bond, what rate of tax will they pay?**
   Answer reference: Section 4.8.1

10. **State the three types of premium that are available under an income protection policy.**
    Answer reference: Section 5.1.6

11. **Name two common exclusions under a critical illness policy.**
    Answer reference: Section 6.4

12. **Name the two types of lasting power of attorney.**
    Answer reference: Section 7.5.1

13. **Which type of private medical insurance policy has the lowest cost?**
    Answer reference: Section 8.2

14. **Name the main parties involved in the writing of a will.**
    Answer reference: Section 9.3.1

15. **What is the 'proportion of profit' formula used in key person protection?**
    Answer reference: Section 10.5.2

Chapter Three

Retirement Planning

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This syllabus area will provide approximately 24 of the 80 examination questions



1. Pension Provision in Context

Learning Objective

3.1.1 Understand the social and macroeconomic factors influencing the development of pension policy: role of government, policy direction, challenges; demographic trends, longevity and ageing population; registered pensions, main types of pension provision; incentives, disincentives and attitudes to saving, and economic factors and influences

1.1 The Role of the Government

There are various ways that a person can save for their retirement, but what makes a pension different from other methods of saving are the tax advantages offered. No other product receives the same tax incentives as a pension, all put in place to encourage individuals (and their employers) to provide for future retirement.

The UK government's main objective in relation to pension provision is to ensure that people in the UK can enjoy an adequate standard of living, without having to fall back on the state.

However, as was considered in chapter 2, the UK's increasing population and life expectancy can prove challenging. As a result, a number of measures have been taken by the Government over recent years to encourage pension saving, including:

- increasing the state pension age (SPA) for men and women while equalising the age for both sexes
- the introduction of the new state pension
- the introduction of '**auto-enrolment**' legislation to address the lack of private pension provision in the UK

- the introduction of the Lifetime ISA (LISA) to encourage younger people to save for their retirement
- an increase in the individual savings account (ISA) allowance to encourage more savings into tax free products which can be used to top up retirement income, and
- the abolition of the lifetime allowance, which was aimed at encouraging people, specifically public sector workers who are part of a defined benefit scheme, to work longer.

It should be noted that following the election of the Labour government in July 2024, it was announced at the autumn 2024 budget that pensions would be subject to inheritance tax with effect from April 2027. Whilst specific legislation was yet to be enacted at the time of writing, the likelihood is that this may reduce the attractiveness of pensions as a savings vehicle.

1.2 Demographic Trends

The perception of retirement has changed. At one time, individuals would have retired at age 60 or 65, drawn their company pension as well as their state pension, and spent 15 years with their feet up.

This is not the case anymore; there have been medical advancements, people are living longer, some are taking early retirement, and pensioners today have much greater expectations for their retirement, including going on more holidays and taking up expensive pastimes. Scientists believe that the person who will live to age 126 has already been born.

One problem that a lot of countries face is that, as their population gets older, the number of people of working age to support those of pension age drops, and with people now choosing to have fewer children, the future does not look any more promising. The issue in the UK is that the working population pays national insurance contributions (NICs) to fund state pensions, and with fewer people paying national insurance (NI), the strain on the government worsens. The consequence of this for younger generations is a longer time in work, and a reduced state pension; for them, the need for personal savings is ever more apparent.

1.3 Registered Pensions

The main types of pension scheme available are:

- workplace pensions (aka occupational pension schemes), and
- **personal pension schemes**.

These can be either set up as a:

- **defined benefit (DB) pension scheme** – these are always employer occupational schemes, or
- **defined contribution (DC) pension scheme** – these can be personal schemes or employer occupational schemes.

Feature	Defined Contribution (DC) Pension	Master Trust Pension Scheme
Definition	A type of pension where benefits depend on contributions and investment returns	A multi-employer occupational pension scheme run by independent trustees
Pension Type	Refers to the benefit structure	Refers to the scheme governance and legal setup
Risk	Investment and longevity risk borne by the individual	Same as DC – risk still lies with the member
Who sets it up?	Individual (personal pension) or employer (workplace scheme)	A pension provider sets it up for use by multiple employers
Trust-based or contract-based?	Can be either (e.g., GPPs are contract-based)	Always trust-based
Used for auto-enrolment?	Yes, if set up correctly (e.g., NEST, GPPs, master trusts)	Specifically designed for auto-enrolment compliance
Examples	Personal Pension, SIPP, GPP	Nest, The People's Pension, NOW: Pensions, Smart Pension
Governance	Varies – contract-based schemes may have minimal oversight	Oversight from a board of independent trustees
Employer involvement	Varies – employer can choose their provider or scheme	Low administrative burden on employer – provider handles compliance and setup
Regulatory oversight	FCA (contract-based) or TPR (trust-based)	The Pensions Regulator (TPR)

The benefits from a DB scheme are usually based on the individual's final salary, the number of years they have been a member of the scheme and the accrual rate, which is usually expressed as 1/60th or 1/80th of final salary as set out in the scheme rules.

In recent years, particularly in the public sector, there has been a trend towards career average revalued earnings (CARE) schemes. Under this type of arrangement, the member accrues an entitlement on an annual basis, which is 1/60th or 1/80th of that year's earnings, adjusted to allow for inflation. As for most individuals, their earnings increase throughout the course of their career, the final pension will usually be lower under this type of arrangement.

With this type of scheme, the individual knows the amount of pension they will receive at retirement.

In contrast, the benefits from a DC scheme are based purely on the size of the fund at retirement. This depends on the amount of contributions made and the performance of the chosen investments so it cannot be so easily predicted.

If HM Revenue & Customs (HMRC) approves the scheme, it becomes a registered pension scheme and, as a result, enjoys income tax relief on contributions (up to a certain amount), and the fund can then grow free of corporation tax.

Contributions can be made both by the individual and/or their employer. Usually, pension contributions are invested until the chosen retirement date and, at that point, either an income, or a tax-free pension commencement lump sum (PCLS) with a reduced amount of pension income can be taken.

1.4 Attitudes to Saving

Saving for retirement is something a lot of people do not consider sufficiently until they are close to retirement age; large mortgages and having children later in life means that surplus cash is often diverted to other financial priorities.

Although there is a changing perception regarding how much pension income will be provided by the state, this is still in some minds a 'safety net' without which they would be facing a rather grim retirement future.

The tax incentives offered by the government to save towards retirement include:

- income tax relief on contributions
- a pension fund that grows free of income tax and CGT, and
- a tax-free PCLS.

Despite this, private savings towards retirement are often inadequate. The government has also recently abolished the lifetime allowance, which was a limit on the amount which an individual could draw from pension schemes without paying a punitive tax charge.

It is still the case, despite the so-called pension A-Day (6 April 2006, when a new set of pension rules came into force) and pension simplification, that the legislation surrounding pensions is complicated. It is also the case that withdrawn funds are taxed as earned income (other than the PCLS), and funds cannot be withdrawn until (currently) age 55. This is due to rise to 57 from 6 April 2028.

For these reasons, many people might prefer the easier and less-complicated ISA products despite the fact they do not offer the same income tax relief on contributions. They do, however, provide the same tax-free growth, and there is no tax on withdrawals. There is also no age restriction as to when the benefits can be taken.

To further encourage a savings culture, the LISA was introduced. This is an investment product for individuals aged between 18 and 40 and is designed to encourage younger people to save for their future. Both cash, as well as stocks and shares, can be held in a LISA, or a combination of both can be chosen.

The government pays a 25% bonus on an annual contribution of up to £4,000 (so a maximum of £1,000 per year). This £4,000 contribution can be made until the individual is aged 50. The contribution limit counts towards the annual ISA limit, which is currently £20,000.

The accumulated fund can only be used to buy a first home, and/or for use as pension income from the age of 60.

If cash or assets are withdrawn before then, there is usually a 25% charge, unless the individual is terminally ill.

2. State Pension Benefits

Learning Objective

3.2.1 Understand State Pension benefits

The state pension is a benefit based on the payment of NICs and is designed to prevent poverty when someone reaches old age. Legislation surrounding the state pension has changed radically over the years; currently we have a situation where the rules that apply depend on when state pension age (SPA) is reached.

An individual can claim their state pension when they are within four months of reaching their SPA. The state pension is not received automatically – individuals need to actually make a claim for it, though they will be notified when it is due.

A person's SPA is worked out based on their date of birth and gender, and is regularly reviewed to ensure that it is fair but also affordable; as mentioned previously people are living longer and they are, therefore, spending more time in retirement than ever before.

Currently, the SPA is 66 for both men and women, having previously been 65. Prior to this, women had a lower age of 60. By 2028, the SPA for both men and women will be 67; and by 2039 it will be 68.

A regular review period of five years was introduced, the first of which took place in 2017; the resulting report recommended that the SPA for both men and women be increased to 68 between 2037 and 2039.

If someone reached their SPA before 6 April 2016 they would have been entitled to the basic state pension (BSP).

2.1 The Basic State Pension (BSP)

The original old age pension was first introduced to Britain in 1908 under the government led by David Lloyd George. When introduced, it was designed to provide approximately 20% of the average earnings at age 70. The percentage was not too bad but, as life expectancy in 1908 was about 49, the minimum age requirement was a few years too high for many. It was later rebranded the basic state pension (BSP).

The basic state pension applies to:

- men born before 6 April 1951, and
- women born before 6 April 1953.

The BSP has seen a number of changes over its 100-year plus life and will continue to see them. The most recent development, in April 2016, has been the introduction of a new state pension which has no earnings-related element. This has meant that the state pension has been separated from the non-state regimes. This does not, however, mean that matters are any simpler. But, as an adviser, it is important to know about both the new and the old system as both will continue to operate depending on the age of

your client. In order to receive the full BSP, a person needed to have paid (or to have been credited with) 30 qualifying years of paying NICs.

For the tax year 2025–26, the full pension is £176.45 per week. The full pension increases each year by a guaranteed amount set out in legislation and known as the triple-lock. This is the highest of the following:

- **Earnings** – the average percentage growth.
- **Prices** – the percentage growth in prices measured by the consumer price index (CPI).
- **2.5%**.

For the 2022–23 tax year alone, the average earnings element of the triple was suspended. This was due to a drop in average earnings to July 2020, caused by workers being furloughed and taking pay cuts during the coronavirus (Covid-19) pandemic which led to a rebound the following year.

This had created a situation where maintaining the average earnings link would have required an increase of over 8%. The government felt that this was not reasonable in view of the unique circumstances. The triple lock was reinstated in its full form for the following tax year. However, doubts remain over its long-term viability given the need to balance public finances in the aftermath of the Covid-19 pandemic and the energy crisis.

In addition to this, the person may also have been eligible for the additional state pension (ASP). How much someone would have been entitled to depends on earnings, their NICs record, and whether they had been contracted out of it or not. When someone was contracted out this meant they did not build up any entitlement to ASP. An amount of their NICs which would normally have paid for ASP was instead paid into their workplace pension scheme. Contracting out ended in April 2016 but, someone's contracting out history will still have an impact on the amount of state pension received.

Any ASP is automatically paid with the basic state pension – in other words, it does not need to be claimed separately.

The BSP can be deferred, which will increase payments when they are eventually claimed. The deferral rules specific to BSP will still apply to an individual even if they take the BSP after 6 April 2016.

For someone who reached their SPA after 5 April 2016, they will qualify for the new state pension.

2.2 The New State Pension

The new state pension was introduced with effect from 6 April 2016, applying to:

- men born on or after 6 April 1951, and
- women born on or after 6 April 1953.

To qualify for any amount of new state pension, individuals will need ten qualifying years on their NI record; to receive the full state pension, they will need 35 qualifying years. In 2025–26, the pension is £230.25 per week.

There are transitional provisions for those who have built up qualifying years or credits prior to 6 April 2016, to ensure they do not receive a lower pension amount than they would have received under the previous system rules, so long as they meet the new ten-year minimum **qualifying period**.

When an individual reaches their SPA, the amount that they would have received under the old rules is compared to the amount that they can receive if the new system was in place at the start of their working life; they will then receive the higher of these two figures. This starting amount will include a deduction if the individual was contracted out under the old system.

The new state pension can also be deferred but the rules are not as generous as the deferral rules for the BSP.

2.3 Defined Benefit (DB) Schemes

Learning Objective

3.2.2 Understand defined benefit (DB) schemes

The benefits from DB schemes are a promise to pay a pension based on the:

- member's years of service in the pension scheme
- member's pensionable salary, and
- scheme's accrual rate.

Example

Jordan joined XYZ ltd when he was 44 and, having worked the required one-year probationary period, he was able to join the company's final salary DB scheme. He is soon to retire at age 65. He has an annual salary of £45,000, plus £7,000 in bonuses. The scheme is a 1/60th scheme, and his pension is based on his basic salary only. His estimated pension benefit today is, therefore:

20/60 x £45,000 = £15,000 pa.

Some schemes, generally in the public sector, such as the National Health Service (NHS) scheme, provide a tax-free lump sum as well as an income.

Most private sector schemes allow tax-free cash to be taken via **commutation**. This means giving up some of the annual pension income in exchange for a lump sum.

These benefits are not reliant on investment returns and so the investment risk is borne by the employer. The employer, therefore, has a commitment to pay a pension income to a member for the rest of their life once they reach retirement age, which is, of course, an unknown period of time.

Most schemes are contributory; this is where employees contribute a fixed percentage of their salary. Trustees are the owners of the scheme assets and it is their role to safeguard those assets for the benefit of the members and to ensure that scheme funding is sufficient to meet the liabilities.

DB schemes must also increase pension payments by statutory amounts.

If someone leaves a scheme having built up preserved benefits, these are held within the scheme and revalued to retirement date. At retirement, there is also a statutory requirement to increase the benefit being paid. These are valuable benefits to the member of a DB scheme, but they increase further the pension fund liabilities.

The advantages and disadvantages of a DB scheme can briefly be summarised as follows:

Advantages	Disadvantages
Member can calculate approximately what they will receive in retirement	Benefits have to be taken all at once
Member benefits from statutory revaluing to keep pace with inflation	No opportunity to phase the pension commencement lump sum or the income
Members do not have any of the investment risk	No flexibility in terms of the amount drawn
The member can be sure of not outliving their funds	The member is unable to manage their tax position using the scheme
No exposure to annuity rate risk	Death benefits are usually more restrictive than a defined contribution scheme
The member benefits from the protection of the Pension Protection Fund	If the employer goes bust, the scheme may enter the Pension Protection Fund and the promised pension might be reduced

The advantages of a DB scheme lie mainly with the member and not with the employer, which is taking virtually all the risk associated with the pension. Due to medical advances, increasing life expectancy and (until recently) low interest rates, such schemes have become increasingly expensive to run. As a result, employers have reacted by attempting to reduce their costs by:

- closing the scheme to new members
- closing the scheme to all members
- reducing the accrual rate, eg, from a 1/60th scheme to a 1/80th scheme
- increasing the normal retirement age so that the pension is paid for a shorter period
- altering the remuneration figures used: there is a growing trend for career average schemes, which use the average of revalued earnings for an individual over the whole of their period in the scheme, rather than just the final, probably highest, salary
- increasing employee contributions, and
- reducing pension increases to the statutory minimum (rather than perhaps higher discretionary increases as in the past).

3. Defined Contribution (DC) Schemes

Learning Objective

3.2.3 Understand defined contribution (DC) schemes

With a DC scheme, the only known factor is the amount that is invested on behalf of the member.

The uncertainties that exist include:

- the performance of the chosen fund(s)
- future inflation rates
- the level of provider charges, and
- future annuity rates (if an annuity is to be purchased).

DC schemes still have trustees, but their role is less significant than those appointed to safeguard DB schemes as they have no set liabilities to meet.

The major difference between a DC scheme and a DB scheme is that with a DC scheme, the risk is transferred almost entirely to the member.

Furthermore, statutory revaluation does not apply to DC schemes so when a member leaves a scheme with preserved benefits they will be relying solely on the performance of the fund.

The advantages and disadvantages of a DC scheme can briefly be summarised as follows:

Advantages	Disadvantages
Opportunity to access benefits flexibly	Members carry all the risks
Ability to take PCLS without income and phase withdrawal	Poor fund performance could lead to lower benefits
Management of the member's tax position	Unknown benefits making it hard to plan ahead
A more flexible range of death benefits	Individuals could run out of money if they access pension flexibly
Opportunity to purchase a full or partial annuity at a later date	

4. Pension Scheme Taxation

Learning Objective

3.3.1 Be able to interpret how the HMRC tax regime applies to pensions planning: taxation of contributions to pension schemes, and relevant tax relief; taxation of retirement and death benefits from pension schemes; annual allowances, lifetime allowance, transitional protections, money purchase annual allowance and other limitations on tax relief; tax treatment of non-registered pension in outline

4.1 Introduction

As already mentioned, the government offers tax incentives on pension savings as a way of encouraging individuals to save for their own retirement. To be eligible for the tax concessions, the pension scheme must be registered with HMRC.

The tax concessions are:

- tax relief on contributions
- tax-free growth and income in the fund, and
- tax-free PCLS.

4.1.1 Pension Contributions

Contributions can be made by individuals, by the employer of the individual, or by a third party for someone else (ie, a parent for their child). Any amount can be contributed to a pension scheme, but there is a limit on the amount that can receive tax relief.

The maximum gross contribution that can be made by an individual is 100% of their relevant UK earnings in a tax year or £3,600, whichever is the greater.

To receive any tax relief, an individual must:

- be under age 75
- be a relevant UK individual, and
- have relevant UK earnings.

You should note that contributions can be paid after an individual has reached age 75 – they just will not qualify for tax relief.

A relevant UK individual must:

- have relevant UK earnings, chargeable to income tax for that tax year
- be resident in the UK at some time during the tax year, or
- have been resident in the UK at some time during the last five tax years and have been a UK resident when they joined the pension scheme, or

- have for that tax year earnings from overseas Crown employment subject to UK tax, or
- be the spouse or civil partner of that individual with earnings from overseas Crown employment that is subject to UK tax.

Relevant UK earnings are defined as:

- income from employment, such as pay, wages, bonuses, overtime or commission
- income from a trade, profession or vocation
- income from a UK and/or European Economic Area (EEA) furnished holiday lettings business
- patent income, and
- income from overseas Crown employment.

4.1.2 Employer Contributions

Contributions for an employee made by their employer are unlimited, paid gross and can be offset as a business expense for corporation tax purposes.

However, in order to receive tax relief contributions they should be *'wholly and exclusively for the purpose of the business'*. HMRC could decide that the employer contribution is excessive and not give full tax relief – however, this would be unusual.

4.1.3 Methods of Tax Relief

Tax relief on contributions to personal pensions (including group personal pensions) is given by the 'relief at source' method. This means that contributions are paid after deducting basic rate tax. This basic rate of tax is then claimed from HMRC by the **scheme administrator** and added to the pension fund.

Tax relief at source is always given at basic rate, despite the fact that the individual paying the contribution could be a non-taxpayer, a basic rate taxpayer or a higher rate taxpayer:

- A non-taxpayer can pay up to £3,600 (gross) and still deduct basic rate tax, making their contribution £2,880 net.
- A basic rate taxpayer receives the correct amount of tax relief immediately.
- A higher rate taxpayer can claim back an extra 20% of tax relief via a self-assessment tax return.
- An additional rate taxpayer can claim back an extra 25% of tax relief via a self-assessment tax return.

Where a higher or additional rate taxpayer makes a pension contribution, their basic and, if appropriate, higher rate bands will be extended by the gross amount of the contribution in order to claim the relief. Should the member not be required to complete a tax return then relief may be claimed by contacting their local HMRC office and requesting an adjustment to their tax coding.

The net pay method is where an individual's gross pay is reduced by the pension contribution before income tax is deducted.

Contributions to DB pension schemes receive tax relief by this method.

Other employer occupational pension schemes can choose, either the relief at source or the net pay method for receiving tax relief.

Example

Karim is a higher rate taxpayer and contributes £1,000 gross each month to his pension scheme.

Using the relief at source method, Karim would only pay £800 as a contribution to the pension scheme as he can deduct basic rate tax of 20%. The £200 is reclaimed from HMRC by the pension provider and added to his pension fund.

As Karim is a higher rate taxpayer, the additional 20% income tax relief is claimed via self-assessment.

Using the net pay method, Karim's gross pay would be reduced by £1,000 each month before income tax is calculated and deducted. This saves him income tax at his highest marginal rate of 40%; in other words, he has received £400 in income tax relief.

4.1.4 Annual Allowance

The annual allowance is the total amount of pension savings (both through individual and employer contributions) that can qualify for tax relief in each year.

The contributions are measured against the annual allowance in each **pension input period (PIP)**. Prior to 2016, a member's PIP could be changed, however since April 2016, the PIP for everyone is aligned with the tax year (6 April to 5 April).

Transitional rules were put in place which meant that any PIP open on the 8 July 2015 was closed on that day and for everyone the next PIP was 9 July 2015 to 5 April 2016. Due to the alignment of PIPs, the 2015–16 PIP was split into two mini PIPs for the purpose of the annual allowance.

Any amount paid in excess of the annual allowance will incur an income tax charge, which effectively takes away the income tax relief given at source.

This is an important point to make: all contributions receive income tax relief when they are made. The annual allowance is considered at the point of self-assessment to determine if all the tax relief that has been given can be kept. If the annual allowance has been exceeded, then the individual will be liable for an **annual allowance charge** at their marginal rate of income tax.

The annual allowance for the tax year 2025–26 is £60,000. This applies to pension savings into a registered pension scheme or an **overseas pension scheme** if either the individual and/or their employer qualifies for UK tax relief on those pension savings.

Prior to the 2023–24 tax year, the annual allowance had been at £40,000 since 2014–15. Prior to that, there were a succession of cuts, with the figure having previously stood as high as £255,000.

The increase was one of a range of measures introduced as part of the spring budget 2023 aimed at reducing the overall pensions tax burden on high earners. The purpose of this was to encourage highly skilled individuals to remain in work as opposed to retiring early due to prohibitive tax penalties.

There was a particular focus on the public sector, whereby there was concern that senior workers with significant defined benefit pensions were being lost to the workforce prematurely due to the growth within their pensions. This was largely targeted at doctors given the NHS backlogs in the aftermath of the Covid-19 pandemic. However, it may also be of relevance, for example, to senior members of the police or armed forces.

The Tapered Annual Allowance

Individuals with adjusted income in any given tax year greater than £260,000 have their annual allowance restricted for that particular tax year, providing that their threshold income (broadly adjusted income less pension contributions/accruals from all sources) exceeds £200,000.

For every £2 of adjusted income above £260,000, the annual allowance will be reduced by £1 until the annual allowance is reduced to £10,000. This is known as '**tapered annual allowance**'.

Example

For the 2025–26 tax year, Samuel earns £370,000. Samuel's income exceeds the adjusted income limit by £100,000. Samuel's annual allowance would be reduced to £5,000, which is the standard annual allowance of £60,000 less the £55,000 reduction under the tapering rules.

However, the minimum that the annual allowance can reduce to under the tapered annual allowance rules is £10,000, so Samuel will have a tapered annual allowance of £10,000.

Adjusted income includes not only earned income, but also the value of any pension contributions made by their employer or a third party.

The maximum reduction to the annual allowance will be £50,000, so anyone with adjusted income in excess of £360,000 will have an annual allowance of £10,000.

This results in an annual allowance of £60,000 for those with an adjusted income of less than £260,000, a reducing annual allowance for those with adjusted incomes between £260,000 and £360,000, and an annual allowance of £10,000 for those with an adjusted income over £360,000.

The Carry Forward of Unused Allowance

If an individual does make pension contributions of more than the annual allowance in a tax year, they may not actually be liable for an annual allowance charge for that year. This is because they can carry forward any annual allowance that they have not used in the previous three tax years to the current tax year if they have sufficient UK taxable earnings in the current year to claim tax relief.

This amount of unused annual allowance can then be added to the current year's annual allowance, giving them a higher amount of available annual allowance to offset against that year's **pension input amount**.

The 'carry-forward rule' allows an individual to make occasional large amounts of pension savings without having to pay the annual allowance charge.

For example, a self-employed individual, who in one year makes a large profit, could make pension contributions that are larger than normal and are also above the annual allowance level. This will depend, of course, on the amount of contributions that they have been paying in pension input periods that end in the previous three tax years, and on the amount of unused annual allowance that they have available to carry forward.

As previously stated, there is no legislative limit on the number of contributions that can be paid into a registered pension scheme, either by the member or their employer. There is, however, a limit on the amount of contributions paid by an individual that qualifies for tax relief; this limit is the amount of the individual's relevant earnings (or £3,600 – whichever is the higher).

The amount of contribution from an employer that could qualify for tax relief is potentially unlimited. In order to qualify, the contributions are simply required to be wholly and exclusively for the purposes of business.

However, it is important to note that if total contributions exceed the employee's annual allowance (plus any applicable carry-forward), an annual allowance excess tax charge will become payable. This applies whether the contributions are paid by the employee, the employer or any third party.

It should also be noted that:

- the annual allowance for the current tax year must be fully used first
- any unused allowances from the previous three tax years can then be accessed (the earliest year first) and used
- carry forward relates to unused annual allowance and not unused tax relief
- any contribution made in the current tax year, even when mopping up previous unused allowances, will be assessed for tax relief purposes against tax-relievable income in the current tax year; this means that individuals must have sufficient earnings in the current tax year to fully benefit from any tax relief, and
- the member must have been a member of a registered pension scheme in the year from which carry forward is being used.

Example of Carry Forward

Danielle earns £105,000 in 2025–26. She has been a member of a registered pension scheme for five years but has not made any contributions in the last four years.

The years we need to consider here are the three years before this tax year, ie, 2022–23, 2023–24 and 2024–25.

Danielle can carry forward £40,000 from 2022–23 and £60,000 from 2023–24 and 2024–25, and she also has an annual allowance of £60,000 for this tax year.

Based on carry-forward rules alone, Danielle can contribute £220,000. However, in practice, due to the earnings limitation, the maximum tax relief she will receive is based on her earnings in 2025–26, which are £105,000.

The annual allowance is considered, at a later date, to see if she can keep all the tax relief or whether she has to repay any through an annual allowance tax charge.

Money Purchase Annual Allowance (MPAA)

Money purchase annual allowance (MPAA) was introduced in 2015 as a result of the pension freedom legislation applying to defined contribution schemes, and was designed to stop individuals abusing the new rules.

Those individuals who flexibly access their money purchase funds in certain circumstances will trigger the MPAA rules; these limit future contributions that can be made to money purchase pension plans to £10,000.

The circumstances that trigger the MPAA include:

- taking withdrawals from a flexi-access drawdown (FAD) fund
- taking an **uncrystallised funds pension lump sum (UFPLS)**
- converting a **capped drawdown** plan to a FAD plan, and
- accessing a flexible annuity.

It is important to note that the MPAA only applies to money purchase pension contributions made by the individual once one of the events above occurs.

Funds that are designated to allow FAD do not trigger the MPAA – only withdrawals trigger the MPAA.

The total annual allowance of £60,000 (or a lower amount, if subject to tapering) plus any amounts carried forward from the previous three years, continues to apply to other pension benefits.

Any unused MPAA in a tax year cannot be carried forward. In the year that the MPAA is triggered, any money purchase contributions made before the trigger date do not count towards the MPAA (but they do count towards the standard annual allowance).

Pension Input and the Annual Allowance

When dealing with a **money purchase arrangement**, it is very straightforward to see how much of the annual allowance has been used up by pension contributions made. With DB schemes, it is not so obvious as there is no defined contribution as such, so instead, we need to calculate the increases to pension rights.

We do this by looking at the increase in an individual's pension entitlement over the course of the year, and then applying a factor of 16 to the increase. As can be seen from the example, simple increases can be valued at more than the annual allowance which necessitates being able to carry forward unused reliefs.

Example

Julian works for AUK ltd, which operates a 1/60th final salary DB scheme. At the start of the year, Julian had 25 years' service and earned £30,000. At the end of the year, this increases to 26 years' service and his earnings have increased to £39,000. The calculation to establish the 'contribution' to be set against the annual allowance is as follows:

Revised pension entitlement	26/60 x £39,000	=	£16,900
Previous pension entitlement	25/60 x £30,000	=	£12,500
This is increased by the CPI (let us assume 3% for this example)	£12,500 x 1.03	=	£12,875
Increase in pension entitlement	£16,900 – £12,875	=	£4,025
Deemed pension contribution	£4,025 x 16*	=	£64,400

*A factor of 16:1 is used to calculate **pension input amounts** for DB schemes.

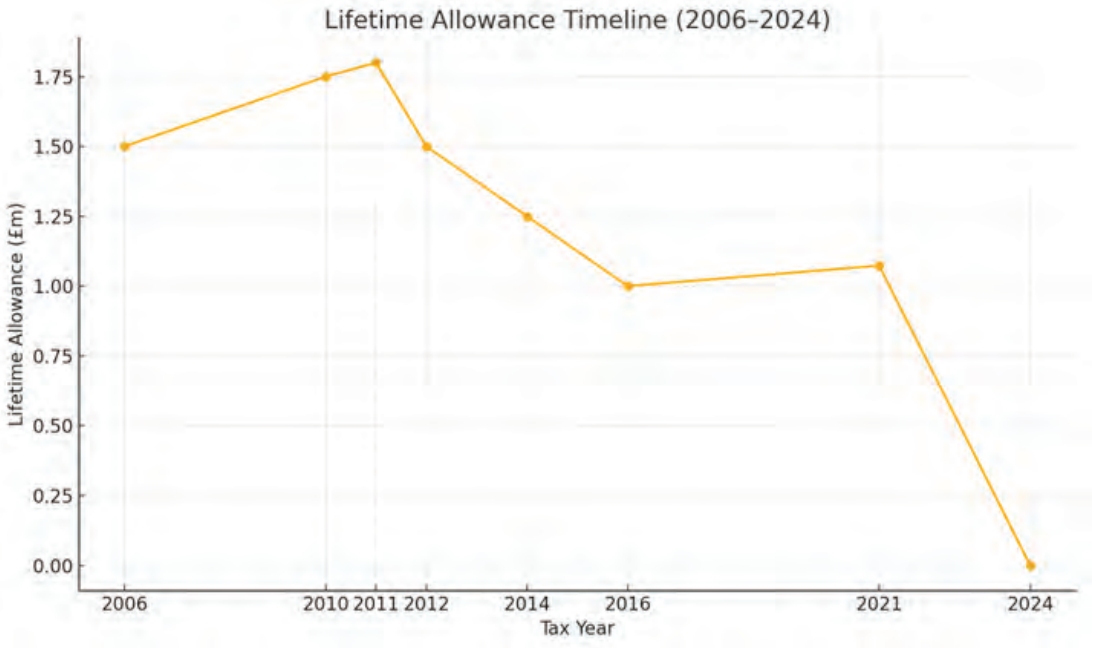
4.1.5 The Lifetime Allowance (LTA)

The lifetime allowance was a limit on the amount of benefits that can be taken from pension plans during an individual's lifetime or on their death without incurring a tax charge. The lifetime allowance was originally introduced for the 2006-07 tax year and set at £1,500,000.

The date of introduction, 6 April 2006, was known as 'A-day'. It was intended to mark the start of pensions simplification as a number of historic tax regimes applying to different types of pension were consolidated into one uniform regime.

The allowance increased incrementally to a peak of £1,800,000 in the 2011-12 tax year. Following that, it suffered a series of cuts, back to £1,500,000 in the 2012-13 tax year, £1,250,000 from the 2014-15 tax year and £1,000,000 in the 2016-17 tax year. It was then planned to increase annually with the CPI; however, from 2021-22, it was frozen at that year's level of £1,073,100. Where benefits exceeded this, a tax charge would be applied to the excess when crystallised. This was 55% where taken as a lump sum, or 25% where taken as taxable income, for example through a flexi-access drawdown plan.

However, during the spring budget 2023, it was announced that the tax charge would be reduced to zero for the 2023–24 tax year. The lifetime allowance itself would then be abolished with effect from the 2024–25 tax year, which has now been completed.



Under the lifetime allowance regime, there were 13 benefit crystallisation events:

- **Taking pensions:**
  - **BCE 1** – when funds were designated to provide a **drawdown pension**.
  - **BCE 2** – when a member became entitled to a **scheme pension** (from a DB or DC scheme).
  - **BCE 3** – when a scheme pension was increased beyond an allowable amount.
  - **BCE 4** – when a member became entitled to a **lifetime annuity** under a money purchase arrangement.

- **Unused funds at age 75 or on earlier death:**
  - **BCE 5** – when a member reaches age 75 under a DB arrangement without having drawn all or part of their entitlement to a scheme pension and/or lump sum.
  - **BCE5A** – when a member reaches age 75 with a **drawdown pension fund**.
  - **BCE 5B** – when a member reaches age 75 with unused money purchase funds.
  - **BCE 5C** – when a member dies before their 75th birthday, and any **uncrystallised funds** were designated to provide dependants' or nominees' FAD pension within two years of death.
  - **BCE 5D** – when a member dies before their 75th birthday, and any uncrystallised funds were designated to provide dependants or nominees with an annuity within two years of death.

- **Lump sums:**
  - **BCE 6** – when a member became entitled to a relevant lump sum.
  - **BCE7** – when a relevant lump sum death benefit was paid on the death of a member.

- **Transfer to a qualifying recognised overseas pension scheme (QROPS):**
  - **BCE8** – when a member's benefits were transferred to a QROPS.

- **Other:**
  - **BCE 9** – when certain payments were made to, or in respect of, a member:
    - payments of 'arrears' of pension after death
    - excessive PCLS based on pension errors
    - PCLS-type lump sums paid after death.

4.1.6 Valuing Different Pension Plans against the LTA

To value how much of the LTA had been used for money purchase schemes, it was simply the fund value that was needed.

For DB schemes, there is no fund as such; instead, the deemed fund was calculated as follows:

- If the pension was not yet in payment, it was the accrued pension entitlement x 20, plus the value of any lump sum taken.
- If the pension was in payment before A-day (2006), it was the pension amount x 25.

The difference between 20 and 25 was to allow for the fact that a cash lump sum may have been taken.

Example

Jane is 70 years old. She retired from her job as a company director in 2005 and enjoys a pension of £50,000 pa from this employment. She started to do consultancy work a couple of years ago and is considering starting a new pension plan based on the earnings she receives. She would like to know what scope she has for pension planning within her LTA.

£50,000 x 25 = £1,250,000 (ignore the lump sum as the pension was in payment before A-day).

Based on the current LTA of £1,073,100 million and 2022–23 rules, she has no scope to accrue further pension without incurring a significant tax penalty. However, on the basis that the abolition of the lifetime allowance continues as planned, this could offer opportunities to do so.

Example

Leo is to retire in 2024–25 on a final salary pension of £25,000, and he will receive a lump sum of £60,000. This will be calculated as a £560,000 'fund' to set against the LTA, worked out as:

£25,000 x 20 + £60,000 = £560,000.

Protecting Pension Funds Prior to 2006

When the LTA was introduced in 2006, some individuals had already accrued pension funds in excess of the LTA at that time, or were getting close to doing so. Likewise, when it was reduced in 2012, 2014 and 2016.

As a result, higher allowances were made available through various protections and enhancements, as follows:

- Primary protection.
- Enhanced protection.
- Fixed protection 2012, 2014 and 2016.
- Individual protection 2012, 2014 and 2016.
- Pension credits and debits on divorce.
- Non-UK residents or international transfers.

While the lifetime allowance has been abolished, the protections are still of relevance given that those holding them can benefit from higher lump sum allowances and lump sum & death benefits allowances, which we will come onto later.

Those affected individuals had three years from A-day (ie, until 5 April 2009) in which to register for primary and **enhanced protection**.

Primary Protection

This was available if someone had pension rights valued at over £1.5 million on 5 April 2006; £1.5 million was the LTA in 2006–07. They could then apply to HMRC to protect those rights from any LTA charge when those rights were crystallised (or came into payment). This application had to be made before 5 April 2009.

Protection of the pension rights was given by allowing a higher personal LTA than the standard LTA; this was worked out by applying an additional factor to the current standard LTA at the time that the benefits are actually taken.

The factor was called the primary protection factor and was calculated as follows:

$$\frac{\text{Total value of benefits at 5 April 2006} - £1.5\text{m}}{£1.5\text{m}}$$

The result is rounded down to two decimal places and can then be added to '1' to be applied to any existing LTA amount. This will increase the LTA for that individual.

The LTA subsequently increased and, by 2011–12, it was £1.8 million. However, the following tax year, 2012–13, this was decreased to £1.5 million.

In order to maintain the value of the primary protection at 2011–12 levels, the primary protection factor was applied to the figure of £1.8 million. This was known as the underpinned lifetime allowance. The intention was that when the standard allowance increased above that level again then the underpin would no longer be required. However, that is not something that ever ended up happening in the event.

Example

Imani had combined pension funds totalling £1.8 million in 2006. Her primary protection additional factor is calculated as follows:

$$\frac{£1.8m - £1.5m}{£1.5m}$$

The additional factor was 0.2. To maintain the value of her primary protection at 2011–12 levels, the additional factor was applied to the current standard LTA figure or, rather, in this case, £1.8 million where this was greater than the current standard LTA at the time of the BCE. So, Imani's LTA would be £1.8 million plus 0.2 x £1.8 million (£360,000).

Enhanced Protection

As its name suggests, enhanced protection provides full protection for the value of the whole of an individual's pension rights. There are, however, key points to clarify which differentiate it from primary protection, including:

- individuals could claim enhanced protection regardless of the value of their pension rights at 5 April 2006, and
- in return for this additional protection, no further relevant benefit accrual could be made to registered pension schemes; the term 'benefit accrual' means further contributions to defined contribution schemes or increases in DB schemes greater than 5% or inflation as measured by the retail prices index (RPI).

Applications had to be made to HMRC before 5 April 2009.

Enhanced protection could be lost if the individual became an active member of a registered pension scheme. However, following the abolition of the lifetime allowance, such membership became possible again with effect from 6 April 2023.

Fixed Protection

On 6 April 2012, the LTA was reduced from £1.8 million to £1.5 million. This would have affected those individuals who had built up savings of more than £1.5 million, or had expected to do so on the basis that the LTA would not reduce.

To allow for these circumstances, **fixed protection** was introduced which enabled individuals to crystallise benefits worth up to £1.8 million without paying the LTA charge.

Individuals had to apply before 6 April 2012, and could not accrue future benefit, though again this has now been changed following the abolition of the allowance. You should also note that an individual cannot have fixed protection if they have either primary or enhanced protection.

On 6 April 2014, the LTA was reduced from £1.5 million to £1.25 million. Fixed protection 2014 was introduced for those individuals who had already built-up pension savings of more than £1.25 million, or who expected to do so. Applications could have been made to retain the LTA at £1.5 million if the individual applied before 5 April 2014. Requirements stated that no further benefits could be accrued in the future, though again this is now possible following the abolition of the allowance.

An individual could not have fixed protection 2014 if they already had primary, enhanced or fixed protection 2012. On 6 April 2016, the LTA was reduced from £1.25 million to £1 million, so fixed protection 2016 was introduced so that the allowance could be retained at £1.25 million, with the provision that no further benefits could be accrued, which again has now been changed.

An individual cannot have fixed protection 2016 if they already have primary, enhanced or fixed protection. The deadline for applications was 5 April 2025.

Individual Protection

Individual Protection 2014 (IP 2014)

This allowed individuals to retain an LTA based on the value of their pension savings at 5 April 2014, up to a maximum of £1.5 million, subject to the total value of all pensions at 5 April 2014 being more than £1.25 million. The following conditions applied:

- Future contributions and accruals were allowed.
- IP 2014 must have been applied for before 5 April 2017.
- Someone could apply for IP 2014 where they already had enhanced protection, fixed protection, but not where they had primary protection.

Individual Protection 2016 (IP 2016)

This relates to the reduction in LTA to £1 million from April 2016. An individual's personal LTA can be fixed to the value of the fund at 5 April 2016 (this must be more than £1 million or £1.25 million, whichever is lower). Further pension benefits can be accrued, but any value above the protected LTA will be subject to the LTA charge. The following conditions apply:

- Applications for 2016 protection started in July 2016, and it was subject to a deadline of 5 April 2025.
- Individuals could not have primary protection or IP 2014.
- IP 2016 could still be applied for if an individual has enhanced protection, or fixed protection 2012, 2014 or 2016.

HMRC also confirmed that those who had already applied for enhanced or fixed protection prior to the date of the budget may, from the start of the 2023–24 tax year, recommence benefit accrual without losing their protections.

4.1.7 The New Regime

The full abolition of the lifetime allowance took full effect from the start of the 2024-25 tax year. For the 2023-24 tax year, the lifetime allowance still existed; however, the rate of tax for exceeding it was set to 0%.

The lifetime allowance has now been replaced with a number of new allowances.

The Lump Sum Allowance (LSA)

This imposes a limit on the amount of tax-free lump sum payments that a member can receive during their lifetime. The limit is 25% of the old lifetime allowance at the time of abolition, which was £1,073,100. The limit is, therefore, £268,275.

It is important to note that where the member previously successfully applied for lifetime allowance protection, they will be entitled to a higher allowance. Broadly, this will be 25% of their protected amount. For example, a member with fixed protection 2014 and a limit of £1,500,000 will be entitled to £375,000 in lump sums.

Enhanced protection had no specific monetary limit. Where the member has enhanced protection with lump sum protection, they may receive lump sum protection noted on their certificate. This means that they can receive the noted percentage, applied to the value of their benefits, as of 6 April 2023. Any contributions made after this date will not be included in the calculation. Members with enhanced protection but no lump sum protection, are entitled to a lump sum allowance of £375,000.

Any lump pension benefits taken other than those covered by the lump sum allowance will be taxed as the earned income of the member. They will not, however, be subject to any other tax charge.

The Lump Sum & Death Benefit Allowance (LSDBA)

The LSDBA places a limit on the total amount of lump sum benefits that can be received free of tax on death prior to the age of 75. This includes lump sums from defined contribution and defined benefit schemes.

The limit is, again, in line with the old lifetime allowance at the date of abolition. However, again, those with protected allowances can benefit from an increased entitlement. The entitlement on death is reduced by any tax-free lump sum which has already been taken during the member's lifetime.

For a member with the standard allowance of £1,073,100, who had already taken the maximum lump sum allowance of £268,275, this would mean that their beneficiaries could take a maximum of £804,825 free of tax. Any excess would be taxed as the income of the beneficiary.

Where the member has passed the age of 75 on death then any benefits will be subject to income tax on the beneficiary in the usual manner. It should be noted that this treatment does not apply to benefit in the form of income, which will be completely tax-free on death prior to the age of 75 as they were previously.

Any event where tax-free income is drawn from a pension will be known as a 'relevant benefit crystallisation event'. This differs from a benefit crystallisation event in that it considers only the tax-free element of the benefits drawn.

A relevant benefit crystallisation event is defined as:

- the individual becoming entitled to a relevant lump sum, and
- a relevant lump sum death benefit being paid in respect of the individual

A relevant lump sum is defined as:

- a pension commencement lump sum
- a serious ill-health lump sum
- an uncrystallised funds pension lump sum, and
- a stand-alone lump sum (SALS).

A relevant lump sum death benefit is any authorised tax-free lump sum death benefit other than a charity lump sum death benefit or a trivial commutation lump sum death benefit.

It is important to note that small pot lump sums are exempt from consideration for each allowance, as they were under the previous regime.

Transitional Tax-Free Amount Certificates

Where lump sums have already been taken prior to the introduction of the allowance then the sum available will be reduced by 25% of the lifetime allowance which has already been taken. This is on the assumption that the member took the 25% tax-free pension commencement lump sum.

In reality, there may be occasions - such as defined benefit scheme members whose scheme offered a very poor commutation rate - where the member did not take the full 25% tax-free cash. In this situation, the member may apply for what is known as a transitional tax-free amount certificate (TTFAC).

The certificate is issued by the scheme administrator and essentially confirms that the member did not take the full 25% allowance and the numerical figure that they did take. This will then be the figure taken into account for the purposes of the allowances above. It should be noted that this assumes that the scheme will still have the records. If neither scheme nor member retain such records then a certificate cannot be issued.

This also previously caused problems for members who had lifetime allowance tests on uncrystallised funds at the age of 75, since they were deemed to have taken a PCLS despite never having taken the benefits in practice. However, legislation was subsequently passed to disregard the age 75 lifetime allowance test where the member had not crystallised any further benefits since.

The Overseas Transfer Allowance

Under the lifetime allowance regime, transfer of funds to a qualifying recognised overseas scheme was a benefit crystallisation event (BCE 8). Following its abolition, such a transfer will now be tested against a new overseas transfer allowance. This is set at the same level as the LSDBA. Benefits which exceed this will be subject to the 25% overseas transfer charge.

Where a member has previously crystallised benefits before transferring overseas, the allowance will be reduced by an amount equal to 100% of the value of the lifetime allowance used prior to 6 April 2024.

4.1.8 Taxation of Benefits on Death

- **Defined contribution schemes** – any individual can inherit unused drawdown funds or uncrystallised money purchase funds on the death of the member, where those funds are used to provide a drawdown pension or pay a lump sum death benefit. For someone who is not a dependant, there will be a nominee's FAD fund. In addition, any beneficiary (that is, a dependant or a nominee) with unused drawdown funds on their death can pass those funds to a successor to be designated to provide a drawdown pension for that individual (a successor's FAD fund) or to be paid as a lump sum death benefit. Any number of beneficiaries may be nominated. The age at death will determine how the pension death benefits are treated.
- **Death before 75** – a member can nominate any individual (a nominee). Payments to that individual will be made free of tax, whether it is taken as a lump sum or accessed through drawdown providing that the funds are designated to an income-producing contract, or paid out as a lump sum death benefit within two years of the scheme member's death. Lump sums are subject to the lump sum and death benefits allowance. Otherwise, the funds will be subject to a tax charge based on the respective beneficiary's marginal income tax rate. The pension fund can be taken tax-free, at any time, whether in instalments, or as a one-off lump sum. This will apply to both crystallised and uncrystallised funds, but it will not apply to dependants' annuities and scheme pensions (ie, where the pension is paid directly out of the scheme assets or paid by an insurance company selected by the scheme administrator). These will continue to be taxed at the beneficiary's marginal income tax rate. Lump sum payments, however, subject to the LSDBA and any which exceed this will be taxed as the recipient's income.
- **Death on or after 75** – DC pension savers can nominate who 'inherits' their remaining pension fund. This fund can then be taken under the pension flexibility rules, and will be taxed at the beneficiary's marginal rate as they draw income from it. Alternatively, they can take the fund as a lump sum, less a tax charge based on the respective beneficiary's marginal income tax rate. One of the major attractions of pensions from a death benefit perspective until recently was their exemption from the estate for inheritance tax purposes. However, it was announced in the autumn budget 2024 that pensions will now form part of the estate, with effect from April 2027.
- **Ill health** – taking pension benefits before age 55 is possible if an individual is in ill health. The Finance Act 2004 sets out the definition of 'ill health' which a scheme must consider when a member requests their benefits on these grounds. Written evidence from a registered medical practitioner will be required. If, because of serious illness, a member is expected to live less than 12 months, they can commute all of their uncrystallised pensions for a tax-free, serious ill health lump sum. For this to be possible, the member must be aged under 75 and commute each arrangement in full, although not all arrangements have to be commuted. This payment is also subject to the lump sum allowance. If the member is 75 or over, then the lump sum is subject to income tax.
- **Refund of benefits** – if a member leaves a DB pension scheme within two years of joining, it is possible to receive a refund of contributions if the scheme rules allow. This only applied to members of a DC scheme if they were a member before 1 October 2015. Members joining a scheme after 1 October 2015 can have a refund if they leave within 30 days of joining. The refund of a member's contributions whether from joining a DC scheme is the same:
  - the first £20,000 is taxed at 20%, and
  - the remainder is taxed at 50%.

- **Preserved benefits –** where someone leaves a pension scheme, they can either transfer the pension to another arrangement or leave it where it is. If they choose to leave it where it is, then the value of a DC fund, including all employer and employee contributions, is the preserved benefit. If the member is close to retirement, a large factor that may influence the decision to transfer or not to is the range of income options the scheme offers. For example, not all schemes will offer FAD and, if this is how the member wants to access their pension, then they will need to transfer their scheme to a more flexible arrangement. With a DB scheme, a leaver becomes a preserved member (or a deferred member). If the pension benefit stays within the scheme, they will stop building up future pensionable as at the date of leaving.

4.1.9 The Tax Treatment of Non-Registered Pensions

Employer-Financed Retirement Benefit Schemes (EFRBSs)

EFRBSs are trust arrangements sponsored by a company for those who wish to accumulate pension benefits outside of a registered pension scheme.

They replaced funded unapproved retirement benefit schemes (FURBSs) which prior to A-day provided benefits over and above those available under normal HMRC rules. However, they did not receive the same tax reliefs available to an registered pension scheme.

FURBSs were replaced by EFRBSs in 2006 and are not registered schemes. However, benefits that were built up in the schemes prior to A-day are still subject to the old tax regime.

Features of EFRBSs

- Employer contributions are not taxable on the employee.
- Employer contributions are not corporation tax-deductible until benefits become payable.
- There is an inheritance tax (IHT) charge when property enters the trust.
- Usual exit charges and periodic charges apply.
- Tax is paid on income and capital gains (unless held offshore).
- There are no investment restrictions.

An EFRBS is not as tax-efficient as a registered pension scheme if the pension allowances are not breached; however, the restriction on higher-rate tax relief for pension contributions can make EFRBSs a viable alternative.

An EFRBS is a type of employer-sponsored discretionary trust used to provide retirement or other benefits outside of the HMRC-registered pension regime. These schemes became more common after the pension simplification reforms on 6 April 2006 (A-day), effectively replacing Funded Unapproved Retirement Benefit Schemes (FURBSs).

EFRBS operate under general trust and employment tax rules and do not benefit from the tax advantages available to registered pension schemes.

Key Features of EFRBS

Feature	Details
Tax on employer contributions	Not immediately taxable on the employee
Corporation tax relief	Only available when benefits are paid out
Inheritance Tax (IHT)	IHT charges may apply when assets enter the trust (relevant property regime)
Trust charges	Subject to exit and periodic charges under discretionary trust rules
Income and capital gains	Taxable unless held offshore, where different rules may apply
Investment flexibility	No specific restrictions on the type of assets held
Registration	Not a registered pension scheme under HMRC rules

Qualifying Recognised Overseas Pension Scheme (QROPS)

A **Qualifying Recognised Overseas Pension Scheme (QROPS)** is an overseas pension scheme which has met HMRC requirements to enable a pension to be transferred from a registered UK scheme. If the scheme is not a QROPS then the transfer cannot be made.

A QROPS is not subject to any UK taxes, including IHT. However, it does become subject to taxation in the jurisdiction in which it is based (which does not have to be the same jurisdiction in which the client is based). It is, for this reason, that locations with low or no taxation are popular choices for locating QROPSs, eg, Guernsey, Jersey and the Isle of Man.

Since 9 March 2017, transfers to a QROPS are subject to a 25% Overseas Transfer Charge, unless one of the following exemptions applies:

- the member and the QROPs are in the same country
- the QROPS is in the EEA and the member is also resident in an EEA country, or
- the QROPS is an occupational scheme provided by the member's employer.

Until October 2024, the exemption applied if both the member and the scheme were located in the UK, any EEA country or Guernsey. However, this was amended after it emerged that it facilitated a loophole allowing members to increase tax-free cash following introduction of the new allowances.

Tax charges will also apply if, within five years of an exempt transfer, the member becomes resident in a different country which does not form part of the EEA. Following the UK's exit from the EU, transfers to EEA-based QROPS are now subject to the 25% charge unless other exemptions apply. EEA QROPS no longer automatically qualify for exemption.

Key Features of QROPSs

- **Income drawdown** – income may be drawn down as the client wishes.
- **Taxation on pension income** – income is subject to the tax rules of the jurisdiction where the QROPS is based.

- **Retirement age** – this is normally 55, but there is flexibility in case of ill health or at trustees' discretion (subject to any legislative restrictions). Special provision can also be made for much earlier retirement for those in specific professions – normally sports-related.
- **Other taxes** – a QROPS is not subject to IHT upon the policyholder's death, and the funds are also not subject to CGT. All these benefits make the product very popular for UK expatriates, particularly as UK-regulated investments are allowed as well as the purchase of buy-to-let properties in the UK and overseas. However, advice should always be sought regarding local tax implications.
- **Other assets** – an individual holding assets in the form of investments, directly or via collective funds, such as unit trusts, can use their QROPSs to purchase those assets, allowing the funds to grow in a tax-efficient manner and, at the same time, moving the assets out of their estate from an IHT viewpoint.

Qualifying Non-UK Pension Scheme (QNUPS)

QNUPS were introduced in February 2010 following HMRC's clarification of the Inheritance Tax (Excluded Property) Regulations 1987. They are designed to allow UK-domiciled and expatriate individuals to save for retirement in an overseas pension without falling foul of UK IHT.

The key aspects of a QNUPS are:

- an individual may contribute to the fund without age restriction, even after retirement
- contributions do not have to be from employment income
- there is no limit to the size of contributions
- income drawdown is at the person's choice, from age 55
- depending on where the person is resident, income may be subject to income tax
- on the person's death, where the QNUPS qualifies as excluded property, any remaining assets may pass to beneficiaries outside the scope of UK inheritance tax, subject to correct structuring and the member's domicile status
- income can be received directly in local currency, reducing the risk of fluctuations, and
- there are no requirements for trustees to report to HMRC, except if the fund holds assets that were originally transferred from an authorised UK pension fund.

5. The Regulatory Landscape

Learning Objective

3.4.1 Know the role of the Financial Conduct Authority (FCA) with respect to pension regulation

3.4.2 Know the role of The Pensions Regulator (TPR) with respect to pensions regulation

3.4.3 Know the role and powers of relevant Ombudsman services

5.1 The Role of the FCA

The Financial Conduct Authority (FCA) is responsible for regulating the standards of conduct in financial services retail markets. In respect of pension schemes, the FCA is responsible for the:

- regulation of the sales, promotion and any marketing of pension plans (except occupational trust-based schemes)
- authorisation of investment firms that run investment plans for pension schemes, and
- authorisation of advisers that provide advice on pension plans.

The FCA has a set of rules and guidance that firms must adopt; full details are found in the FCA Conduct of Business Sourcebook (COBS).

The FCA regularly reviews its requirements with the intention of preventing detriment to customers. Its major regulatory initiative in recent times has been the introduction of the Consumer Duty, a wide-ranging requirement on firms to assess and evidence how they are acting to deliver good outcomes for their retail customers throughout the lifecycle of the products and services they provide.

This has resulted in the introduction of a new Principle 12 to the FCA's Principles for Business, which requires firms to act to deliver good outcomes for retail customers. The FCA has also recently announced its intention to carry out a review of the retirement income advice market aimed at ensuring advice provided to pensioners is appropriate to their needs.

The pensions market in general has been a focus for regulators for a long period. This is mainly due to the potential for harm to customers who are reliant on their savings to fund them for the rest of their lives if advice is not given in their best interests.

Where customer harm has been caused, there are a wide range of powers open to the FCA. These include withdrawing or restricting firms' authorisation, fining or censuring them, or fining or banning individual persons responsible for consumer detriment.

As an example, the FCA has recently introduced a redress scheme aimed at ensuring British Steel staff who received inappropriate advice regarding the transfer of their defined benefit arrangements are appropriately compensated. The FCA estimated that around 1,000 clients would be compensated to the tune of around £49,000 each for the poor advice they received.

5.2 The Role of The Pensions Regulator

The Pensions Regulator (TPR) is the UK regulator of work-based pension schemes; it works with employers, scheme trustees and pension specialists.

TPR is responsible for:

- protecting savings in workplace pensions
- improving the way workplace pension schemes are run
- reducing the risk of schemes ending up in the Pension Protection Fund (PPF), and
- making sure employers provide a pension scheme (automatic enrolment).

TPR works closely with the:

- FCA
- Pensions Advisory Service
- PPF, and
- the Department for Work and Pensions.

5.2.1 TPR Powers

The powers of TPR fall into three categories:

- Gathering information.
- Regulatory and enforcement action.
- Acting against avoidance.

Gathering Information

The Regulator requires that all schemes provide regular returns, as well as information on any significant changes and, in particular, whether a scheme cannot meet its statutory funding requirements.

Regulatory and Enforcement Action

TPR has powers it can enforce if it feels that action needs to be taken to protect members of a scheme – for example, it can:

- issue an improvement notice which requires a specific action to be taken within a certain timeframe
- recover unpaid contributions from an employer
- issue a freezing order
- impose fines, and
- prosecute for certain offences.

Acting against Avoidance

TPR makes sure that employers do not avoid their responsibilities in the knowledge that the PPF will cover their liabilities. The regulator can issue:

- contribution notices, and
- financial support directions and restoration orders.

Another key part of TPR's role is providing education and information, including:

- automatic enrolment guidance for employers
- codes of practice and regulatory guidance for trustees and scheme advisers
- a trustee toolkit
- regulatory intervention reports, and
- research and analysis.

5.3 Role and Powers of The Pensions Ombudsman

The Pensions Ombudsman is an independent organisation set up to investigate complaints regarding pension administration. It can also consider complaints about the decisions made by the PPF, and some decisions made by the Financial Assistance Scheme (FAS). It will consider complaints from:

- members of pension schemes (including personal pensions)
- pension scheme beneficiaries
- employers
- trustees
- managers, and
- scheme administrators.

Before the Pensions Ombudsman considers a complaint, a resolution must have been sought first by writing to the parties involved.

If the complaint is against the trustees or managers of an occupational pension scheme, it should be dealt with under the scheme's internal dispute resolution procedure. The Pensions Advisory Service can also assist in resolving the complaint.

Once the Ombudsman makes a decision, it is final and binding on both parties. However, anyone who is unhappy with a decision that the Ombudsman makes can appeal to the High Court in England and Wales, the Court of Session in Scotland, or to the Court of Appeal in Northern Ireland. Any appeal, however, must be on a point of law.

5.4 Training and Competence (T&C) Requirements

Learning Objective

3.4.4 Know the training and competence requirements for a pension transfer specialist

The introduction of pension freedoms has led to an increased number of members of DB schemes wishing to transfer their benefits.

Because of the valuable benefits that DB schemes provide, the Pension Schemes Act 2015 has brought in new regulations, including:

- if the pension fund is worth more than £30,000, then the member must take appropriate financial advice from an authorised independent adviser
- the adviser must have the necessary permissions to carry on a regulated activity, which means that they must be a **pension transfer** specialist (or the person checking the advice must be a pension transfer specialist)
- to be a pension transfer specialist the adviser must have the appropriate qualification
- since October 2020, new rules require that a pension transfer specialist must undertake a minimum of 15 hours of structured CPD which is specific to that activity in addition to their standard CPD requirements, and
- record-keeping rules mean that records must be kept indefinitely for a pension transfer specialist.

From October 2021, pension transfer specialists are also required to hold a level four compliant investment advice qualification, such as Financial Planning and Advice (FPA).

6. Applying Pensions Law and Regulation

Learning Objective

3.5.1 Be able to interpret aspects of pensions law and regulation relevant to retirement planning: employment law relevant to pensions; pensions, divorce and breakdown of family relationships; bankruptcy law and pension assets; The Pensions Regulator's compliance requirements; Financial Conduct Authority rules; pension protection schemes

3.5.2 Understand the relevant aspects of pensions law and oversight: trust-based and contract-based DC pensions; roles and duties of trustees, administrators and professional advisers

3.5.3 Understand auto-enrolment schemes, employer duties, contributions, workers' opt in/opt out, payroll and default issues

6.1 Employment Law Relevant to Pensions

The European Directive 2000/78 EC established a framework for equal treatment in employment and required member states to implement laws prohibiting discrimination in the workplace. This directive

made it unlawful for pension schemes to discriminate against workers or prospective members of a pension scheme on the grounds of age. The directive was transposed into UK legislation via the Equality Act 2020, which will remain in force post-Brexit, albeit potentially in an amended form.

Since 1 December 2006, trustees must not apply any discriminatory rules and are given powers to amend any scheme rules that are in conflict with the regulations. Any worker who suffers discrimination on the grounds of age in respect of pensions can bring a claim to an employment tribunal against the trustees/employer.

There is, however, a long list of exceptions to the rules, some of which include:

- employers are allowed to operate qualifying periods for occupational schemes before employees are permitted to join a scheme
- they are also able to apply different accrual rates for occupational schemes depending on length of service
- employers may set minimum and maximum ages for admission to schemes, including different ages for different groups and categories of worker
- the actuary may take account of a member's age when performing calculations, such as early retirement penalties
- it is allowable to reduce a dependant's pension where the dependant is more than a specified number of years younger than the member, and
- employers are allowed to pay different levels of contributions for different age bands where the intention is to provide comparable benefits for comparable members.

The Pensions Act 2008 introduced auto-enrolment which meant that employers had to automatically enrol their employees into a qualifying workplace pension by 2018. Employees can **opt out** but must be re-enrolled every three years.

6.2 Pensions and Divorce

With rising divorce figures, legislation was introduced to allow courts to not only split the assets of a couple but also their pension rights as well (Welfare Reform & Pensions Act 1999).

A divorce settlement can look at pension rights in the following ways:

- Balance the pension rights against another asset, eg, the matrimonial home (known as 'pension offsetting').
- Arrange that when the pension is in payment, a pre-agreed proportion of it is paid to the other party (known as '**pension attachment order**' except in Scotland).
- Split the pension at the time of the divorce, giving both parties their own pension pot (known as '**pension sharing**').

It is essential that the value of both spouses' pensions is ascertained (by requesting the pension providers to provide current valuations of each pension pot). Each spouse will not have any right to know what the other's pension value is unless consent is given.

The spouses have to be told that transferring from a final salary (or career average) scheme to a money purchase scheme (or a personal pension) carries a number of risks. The courts have the power to issue a court order to any type of pension scheme, eg, occupational pension schemes (funded and unfunded, approved or unapproved), personal pension schemes, **retirement annuity contracts (RACs)** and Section 32 buyout plans.

The courts will include in their considerations pension plans that spouses are currently paying into, plans that have been deferred and plans that are already in payment.

The only pension arrangements which are considered to be outside the legislation are:

- state benefits
- equivalent pension benefits (EPBs) earned between 1961 and 1975; these are non-revaluing pensions, which were built up when the people were contracted out of the state-graduated pension scheme by their occupational pension scheme, and
- pension rights which arise because the person was a widow, a widower (before the present marriage) or a dependant.

6.3 Offsetting

Offsetting involves valuing pension benefits at the date of divorce; these are then offset against other assets. The individual who has the pension rights retains those rights, while the spouse is given ownership of other assets, eg, the matrimonial home.

Obviously it can be quite difficult to achieve a totally fair split of a couple's assets by offsetting a pension pot against other assets; this is because the pension pot is the largest asset that a person may have and the value can fluctuate more than, for example, property values. Where offsetting is not producing an equitable result, one or other of the alternative options can be used.

The advantage of offsetting is that it enables a clean break.

6.4 Pension Attachment Order

The Pension Attachment Order (also known as 'earmarking') was introduced by the 1995 Pensions Act. With this method, the pension scheme trustees, instructed by the courts, will pay the ex-spouse a percentage of the member's future pension entitlement.

Either party can apply to the courts to have the amount varied (because of changed values and circumstances, for example) and the payment is only actually made when the spouse with the pension crystallises it.

Pension attachment order does have a number of disadvantages, including:

- it does not provide a clean break between the couple
- the ex-spouse can only receive a retirement income when the other party (whose pension pot it is) decides to retire (which may be delayed)
- if the divorce settlement states that there is to be a regular payment of a pension (a periodic payment), the payments will stop on death
- income can stop if the party receiving the pension attachment order remarries, and
- tax is paid on the pension income at the rate charged to the scheme member regardless of the tax status of the ex-spouse.

6.5 Pension Sharing

The Welfare Reform & Pensions Act 1999 gave powers to the courts to split pension rights between husband and wife on divorce.

With this method two distinct entitlements are ascertained, to separate the ex-spouse's entitlement (specified by the court order) from that of the scheme member.

The advantage of this method is that there is now a clean break between the couple.

A **pension sharing order** creates:

- a **pension credit member** (who is the ex-spouse), and
- a **pension debit member** (who is the member).

The pension credit is based on the scheme member's cash equivalent transfer value (CETV). The credit is given as a percentage of the CETV, not a fixed sum of money. The CETV is calculated on the day before the pension sharing order is effective, so it is likely to be higher or lower than the value given at the start of the divorce proceedings. The pension sharing order is effective from the date of the decree absolute.

Example

Damien and Marisha divorced during the 2024–25 tax year after a long marriage. Damien has a personal pension scheme valued at £100,000 at the time of divorce. Marisha does not have a pension scheme of her own.

Their solicitors agreed that the most equitable solution was a 50:50 pension share, and the court issued a pension sharing order accordingly. This gave Marisha a pension credit of 50% of Damien's pension ie., £50,000-which she can use to establish her own pension arrangement.

This amount is fixed based on the valuation at the time of the order.

Even if Damien's pension subsequently increases or decreases in value before the pension provider implements the order, Marisha's entitlement remains £50,000.

The pension credit can be transferred to a pension arrangement of the ex-spouse's choice, providing that the new provider will accept it.

If a transfer-out is not made, and the scheme is willing to accept that the ex-spouse remains with them, then the scheme may make an internal transfer, ie, the ex-spouse becomes a member of the scheme in their own right. The pension credit benefits need not be treated the same as those employees in the scheme, eg, it can be treated as a money purchase, even though the scheme itself is final salary (or career average).

However, pension credit members are entitled to receive any normal increase that is awarded to members with preserved pensions.

Schemes are allowed to charge for handling the administration of pension sharing arrangements, ie, the costs of administering pension sharing should not be borne by the scheme, other members or the taxpayer. The scheme must supply details of its charges to the couple at the time of the first enquiry. Any costs which are incurred because of amending scheme rules have to be borne by the scheme.

Clients should be made aware that transferring from a final salary or career average scheme to a money purchase scheme carries a number of risks. For example, a final salary scheme could provide an income of £50,000 pa, whereas a money purchase scheme would provide a pension fund that an individual must then use to buy an annuity or enter drawdown.

6.6 Bankruptcy and Pensions

If an individual is declared bankrupt, they lose control over any assets that they may have which are passed to the trustee in bankruptcy. These assets are disposed of to help pay the bankrupt's outstanding debts.

The trustee in bankruptcy has no claim on approved pensions (those approved by HMRC) for petitions presented on or since 29 May 2000; these are excluded from the bankrupt's estate.

If someone has an unapproved pension then this would pass to the trustee in bankruptcy as a type of asset.

6.7 The State Pension

The following pensions cannot be claimed by the trustee in bankruptcy:

- state pension, and
- payments due from the state earnings related pension scheme (SERPS), or any similar scheme.

If the individual is receiving payments from a pension, the trustee will consider the money to be a part of normal income. The bankruptcy process means that any income can be used to help pay the bankruptcy debts (assuming the individual can afford it, ie, they will have enough left for necessities). The individual can agree to make a contribution from their income towards their debts (an income payments agreement). Alternatively, the courts can order them to do it (by making an income payments order). In either case the arrangement will last for three years.

You should note that the courts have recently considered two cases where a bankrupt individual is over the age of 55 and holds uncrystallised personal pension funds. In two key cases, including Horton v Henry (2016) EWCA Civ 989, the courts considered whether uncrystallised personal pension funds could be included in an Income Payments Order. The Court of Appeal ruled that undrawn pension funds do not constitute 'income' for the purposes of the Insolvency Act 1986. Therefore, trustees in bankruptcy cannot compel a bankrupt individual to crystallise a pension or access pension drawdown for the purpose of an IPO. Therefore, could it be as part of an income payments order which is what the trustee in bankruptcy in both cases had wanted to do.

The two judges in these cases came to different conclusions and so the Court of Appeal reviewed the cases. In October 2016, the Court of Appeal agreed that a pension fund is not within the definition of 'income' unless the bankrupt person decides to draw it and, therefore, it cannot be subject to an income payments order. In other words, the trustee in bankruptcy cannot demand that the pension is crystallised.

6.8 The Pension Protection Fund (PPF)

The Pension Protection Fund (PPF) is a compensation scheme for members of DB schemes (excluding public sector schemes, and protects members where the employer has become insolvent (since 5 April 2005) and there is no possibility of rescuing the scheme.

Employers that became insolvent before this date may be covered by the Financial Assistance Scheme.

The PPF level of compensation is as follows:

- 100% of pension entitlement for members who have reached the scheme's normal pension age, are in receipt of survivor's benefits, or are in receipt of an ill health pension.
- Payments for service after 5 April 1997 rise in line with inflation subject to a maximum of 2.5% pa (payments relating to service before that date do not increase).
- 90% of pension entitlement for members who have not yet reached the scheme's normal pension age.
- A spouse's pension of 50% of the member's PPF compensation amount.

6.9 The Financial Assistance Scheme (FAS)

The FAS is designed to support members of DB schemes that are not covered by the PPF. The FAS is now managed by the board of the PPF.

The FAS offers help to members who:

- were a member of an under-funded DB scheme that started to wind up between 1 January 1997 and 5 April 2005
- the scheme began to wind-up and did not have enough money to pay members' benefits
- the employer cannot pay the shortfall because it is insolvent, no longer exists or no longer has to meet its commitment to pay its debt to the pension scheme, or
- the scheme started to wind up after 5 April 2005 but are ineligible for help from the PPF because the employer became insolvent before this date.

The scheme closed on 1 September 2016; however, members currently receiving payments from the FAS are not affected by this, nor are those with a deferred entitlement.

The FAS levels of compensation are as follows:

- 90% of accrued pension entitlement at the date of commencement of the winding up is guaranteed. This amount will be revalued up to an individual's retirement date, but is subject to a cap of £45,455.
- The benefit will be paid from the scheme's normal retirement date, subject to the earliest payment date of age 60.
- Payment of benefits based on service after 5 April 1997 will be increased in line with inflation, subject to a maximum increase of 2.5% CPI per annum.
- There is also provision for a 50% spouse's or civil partner's pension.

6.10 Trust- and Contract-Based Schemes

A trust-based pension scheme is governed by a trust deed and has a board of trustees to oversee it. This offers security to scheme members.

A contract-based scheme is used when the employer wants to outsource the pension to a third party who will manage all aspects of the scheme (for example, an insurance company could use a group personal pension (GPP) scheme for the company's employees).

A DB scheme is always set up as a trust-based scheme but an employer with a DC scheme can run this as a contract-based scheme or a trust-based scheme.

Some of the key differences are as follows:

- **Trust-based schemes** typically operate on a 'net pay' arrangement, which means that an employee has their contribution deducted from their pay before tax is applied. They receive full tax relief immediately.
- **Contract-based schemes** must receive contributions from pay after tax and NICs have been deducted. The contribution is treated as being paid net of basic-rate tax and is 'grossed up' by the scheme. The member must then claim any higher-rate or additional-rate tax they are entitled to via self-assessment.

A contract-based scheme is less costly and time consuming for employers compared to a trust-based scheme. Trust-based schemes offer their members protection of the trustees and their expertise in selecting appropriate funds in which to invest their pension contributions. Scheme governance includes oversight of provider performance, communication, and compliance, not just fund selection. Admittedly, this level of protection costs the employer, but may create a better relationship between the employer and the workforce.

6.10.1 The Roles and Duties of Trustees and Administrators

The role of a trustee carries important responsibilities. They must be familiar with all documentation relating to the scheme's administration and they must also have an understanding of pensions and trust law and sufficient knowledge of the basics of occupational pension scheme funding and investment to allow them to exercise their duties. Both the Pensions Act 1995 and the Pensions Act 2004 outline specific responsibilities for trustees, including to:

- maintain audited accounts
- maintain a schedule of contributions
- report obligations to TPR
- draw up a statement of investment principles for their investment manager
- establish a recovery plan if the valuation shows the scheme is not meeting their funding objectives
- hold and invest the assets to achieve the best financial return consistent with security
- act within the provisions of the trust deed
- act impartially at all times and maintain the scheme in the best interest of members, and
- understand the scheme, its provisions and its background.

The Finance Act 2004 requires every scheme to have a scheme administrator. Their duties include:

- registering the scheme with HMRC, reporting events and preparing all returns
- operating tax relief via the relief at source method, and
- providing information to members regarding LTA, transfers and benefits.

6.11 Independent Governance Committees (IGCs)

The establishment of Independent Governance Committees (IGCs) follows the Office for Fair Trading (OFT) 2013 market study of the DC workplace pension market. The study found that scheme members lacked any direct agent to represent their views and that many employees were not actively engaged in their pension saving. With the advent of auto-enrolment, this could mean that many may be enrolled into a default fund without making an active choice.

As a result, the OFT agreed with members of the Association of British Insurers (ABI) that ABI firms operating workplace personal pension schemes would establish and maintain IGCs to assess and raise concerns about value for money on behalf of members. The final rules for IGCs were published by the FCA in February 2015. All providers of workplace personal pension schemes (not just ABI members) are required to establish an IGC.

6.12 Auto-Enrolment Schemes

Auto-enrolment was designed to encourage a retirement savings culture in the UK. The relevant legislation requires all employers to automatically enrol, some or all, members of their workforce (depending on age and salary level) into a pension scheme that meets certain minimum standards.

Some workers also have the right to ask their employer to enrol them. Depending on the worker's age and salary level, employers may be required to make contributions to the pension scheme, adding to the contributions made by their employees.

Auto-enrolment was initially phased in, with the largest employers leading the way, followed by medium-sized employers and lastly small and micro employers. The size of an employer's largest pay-as-you-earn (PAYE) scheme determined at what point the new duties affected their organisation.

At present, TPR writes to new employers to make them aware of their automatic enrolment obligations.

Employers automatically enrol eligible employees into a workplace scheme.

Eligible employees are:

- those aged 22 and above
- under SPA, and
- earning over £10,000 pa.

Contributions are calculated on qualifying earnings between £6,240 and £50,270 (2024/25). A worker becomes eligible for auto-enrolment if they earn over £10,000.

Non-eligible job holders:

- are aged under 22, or between SPA and 74
- earn above £10,000, or
- are workers of any age who have earnings between £6,240 and £10,000.

Non-eligible jobholders have the right to opt-in to the scheme; if they do, the employer must make contributions of no less than the minimum amount.

An entitled worker:

- is someone who has earnings of £6,240 or below, and
- can also join the scheme but the employer does not have to contribute.

6.13 Minimum Contributions

The required pension contributions have been gradually phased in. As of April 2019, the required minimum was 8%, with at least 3% being paid by the employer.

Employees can opt out of the scheme, but every three years, the employer must opt them back in again.

6.14 The National Employment Savings Trust (NEST)

The National Employment Savings Trust (NEST) was established as part of the Pensions Act 2008 and designed to help employers meet their auto-enrolment obligations. Employers can use this scheme or can set up their own individual schemes. NEST charges are 0.3% pa plus 1.8% on contributions. There are no limits on contributions other than HMRC limits.

6.15 Pension Scams and Misselling Issues

Learning Objective

3.5.4 Be able to identify and avoid pension scams

3.5.5 Understand misselling issues

Scams and the risk of misselling have become more commonplace since pension freedoms were introduced. Scammers try to tempt pension scheme members to access their savings with offers of 'guaranteed' high returns and availability of cash. Misselling is the result of unsuitable advice, incorrect explanation of risk (or no explanation at all), or that the necessary information was not given so that a customer ends up with a product that is not suitable for them.

TPR has issued guidance on how individuals can protect themselves from potential pension scammers in the form of the following tips:

- If the individual thinks they have been scammed, they should act immediately by contacting their pension provider to stop a transfer taking place.
- If the individual receives a cold call in relation to their pension, they should hang up immediately as these are almost always scams.
- Be aware of unregulated investments that offer 'guaranteed' returns – including exotic-sounding investments such as hotels and vineyards. Scammers will often try to pressure the individual with time-limited offers.
- Check whether an adviser is registered with the FCA via the FCA's website. If they are not regulated, then the individual may not be covered by the Financial Ombudsman Service (FOS) or the Financial Services Compensation Scheme (FSCS).

Misselling has been a contentious issue in the financial services sector for a number of years. Fundamentally, misselling occurs where a client is either provided with advice which is unsuitable for their needs or, where the sale is not advised, inaccurate or incomplete information, which results in their taking out a product which is not appropriate to their needs.

Some examples of misselling scandals which have occurred over recent years include:

- **Personal pensions** – in the late 1980s and early 1990s, following the introduction of personal pensions, many clients were advised to transfer out of their defined benefit scheme. Clients were often advised that they would receive a higher pension by doing so. However, advisers often failed to adequately consider the risks associated with surrender of a guaranteed pension and this resulted in a costly and longstanding pensions review in the late 1990s. History somewhat repeated itself in this respected following the pension freedoms of 2015, which again brought about a raft of unsuitable defined benefit transfer recommendations and further regulatory review on the matter.
- **Endowments** – introduced as a specific savings plan designed to repay a mortgage at maturity. Many clients were advised to take out an interest-only mortgage as opposed to a repayment one and put the savings into an endowment plan, which would pay off the outstanding balance at maturity. These were often sold as products which would guarantee the repayment and leave a surplus. However, they were often expensive and poorly performing and many customers were left with a shortfall at the end of their mortgage term.

- **Structured products** – these are products which are deemed high risk by virtue of their exposure to a single counterparty and risk of significant loss if that counterparty fails to fulfil its obligations. They are often 'capital protected' so that the client receives at least their initial capital back provided the market does not fall below a particular threshold. However, clients often did not understand the concept of counterparty risk and some were led to believe that they could not lose the money they invested.
- **Payment protection insurance** – this was designed to cover borrowers by making repayments on loans, credit cards or mortgages in the event that they were unable to work through ill health or redundancy. The product was often wrongly presented as compulsory or sold to people who would have been unable to claim on it, or whose ability to claim on it would have been severely restrict due to their circumstances.
- **Packaged bank accounts** – these were often simply added to the customer's bank account in a 'presumptive' manner. At other times, members were charged a monthly fee for accounts including products they already had elsewhere, such as travel insurance, or which would not have been of any benefit to them.

In 2015, the pension freedoms resulted in a widespread removal of restrictions that were previously in place surrounding how and when a member could withdraw funds from their pension scheme. This resulted in a much more widespread demand for defined benefit transfer advice and a significant increase in the number of firms looking to provide this service.

This has resulted in an uncomfortable echo of the late 1980s and early 1990s, with many clients negligently advised to transfer out of their scheme. The FCA has undertaken significant supervisory work in this area which has made clear that some of the advice is not up to standard and penalised the most significant offenders. The British Steel scandal, in which numerous members were negligently advised to transfer rather than accept membership of a new scheme has also dented confidence in the industry. Subsequently, many firms have opted to cease providing defined benefit transfer advice.

An FCA report released in October 2017 stated that 47% of advice in respect of pension transfers was shown to be unsuitable, while a review of advice specifically related to the British Steel Pension Scheme reported that 51% of the advice was unsuitable.

The FCA's update in October 2017 highlighted that poor suitability results were, in part, being driven by firms:

- failing to obtain enough information about clients' needs and personal circumstances
- failing to consider the needs of clients alongside their objectives when making a recommendation, and
- not making an adequate assessment of the risks clients are willing and able to take in relation to their pension benefits.

Throughout 2018, the FCA collected information from an additional 45 firms, following which they conducted further assessment work, including file reviews and visits to 18 firms.

As part of their review of these 18 firms' processes and the advice they gave on 154 transfers, the FCA's suitability findings were as below:

Suitable	74 (48.1%)
Unsuitable	45 (29.2%)
Unclear	35 (22.7%)

This compares with results across the FCA's previous phases of work in this area which found 49% of advice was suitable, 33% unsuitable and 18% unclear.

The FCA remarked that failings included:

- Using generic objectives in fact finds, such as 'flexibility' or 'increase pension' without exploring what these mean to the client; whether the client is able or willing to take the risk required to achieve those objectives, or why they were prioritised ahead of the other needs and objectives of the client.
- Prioritising the provision of 'death benefits' for spouses and dependants in the event of the client's untimely death without exploring alternative options (eg, existing DB scheme benefits or an insurance policy). Firms also failed to take into account the risk that the flexi-access funds could be depleted by the time of the client's death.
- Using generic objectives to justify a transfer, without obtaining the necessary information about those objectives. For example, basing a recommendation on the client's objective to take control of their pension without exploring the reasons for this. This prevents the firm adequately assessing whether the client is able or willing to take the risk required to achieve their objectives.
- Failing to obtain the necessary information about the client's income and expenditure before making a personal recommendation.
- Recommending that clients use a pension commencement lump sum (PCLS) to repay debt or buy a property without obtaining details about the amount needed or exploring alternative finance options.
- Assuming that the client wants or needs a similar income to what they are currently earning, instead of obtaining details on what retirement plans the client actually has or what their income needs are likely to be in retirement.
- Failing to take into account longevity prospects beyond average life expectancy to inform an assessment of the sustainability of income.
- Failing to adequately manage situations where the client had multiple competing objectives.
- Recommending a transfer because the client wanted immediate cash and income in retirement and to leave death benefits to their heirs without considering or demonstrating to the client the impact that achieving one objective may have on the client's other objectives.
- Recommending that the client accesses a PCLS from their pension, when doing so would jeopardise the client achieving their desired or required income in retirement.
- Failing to consider relevant information about their client's needs and circumstances when making a recommendation.
- Failing to adequately take into account the client's proposed retirement date or the costs of the receiving scheme. In some cases, this led to firms recommending clients invest in schemes where

the aggregated charges had the potential to negate future investment returns, so the client was unlikely to financially gain by transferring and had a high risk of being worse off.

- Failing to consider the client's other assets or pension schemes and how these could be used to meet the client's objectives.
- Failing to consider the client's actual health, as opposed to the client's perception of their risk of early death, which may often solely be based on the early death of family members.
- Recommending clients transfer multiple DB schemes without considering whether the client only needed to transfer one scheme to meet their objectives.
- Failing to assess, or using flawed methods to assess the risk the client is willing to take in relation to their benefits. In particular, we saw firms relying on investment risk assessment tools which were not designed to assess the specific risks associated with transferring from a DB scheme. Where transfer risk was assessed, we saw some firms using unbalanced language which was likely to steer clients to respond in a certain way.

The FCA has repeatedly made clear its expectations of financial advisers as well as strengthening the rules around pension transfer advice. Despite this, too much advice the FCA has seen is still not of an acceptable standard. The FCA is concerned, for example, that firms are recommending that large numbers of consumers transfer out of their DB pension schemes despite the FCA's stance that transfers are likely to be unsuitable for most clients.

The FCA continues to visit and request DB transfer-related data from firms that are active in the DB transfer market. These visits/data requests will allow the FCA to complete a full assessment of the firms' approach to DB advice, focusing on key aspects of firms' business models and processes which could give rise to harm.

The FCA has also been active in terms of taking enforcement action against firms found to have provided inappropriate advice. For example, it has issued final notices against Lighthouse Advisory Services and Pembrokeshire Mortgage Centre. In February 2023, it implemented a specific redress scheme for former members of the BSPS after it had found many of them had been given the wrong advice to transfer.

7. Defined Benefit (DB) and Defined Contribution (DC) Schemes

Learning Objective

3.6.1 Understand the key characteristics and application of DB pension schemes: structure, characteristics, attributes and benefits; main types, variations and hybrids; rules and operation of DB schemes; funding methods and issues; membership eligibility criteria and top-up options; factors to consider and benefits of leaving, transfers from DB to DC and DC to DB, early and normal retirement; roles of trustees, and other parties, and scheme reporting; the impact of employer covenants; benefits on ill health or death; private and public sector schemes

3.6.2 Be able to analyse the options available from DB pension schemes regarding retirement planning for individuals: factors to consider and benefits on leaving; early, normal and late retirement; benefits on ill health and death; switching issues and considerations; public sector schemes; retirement benefits; leaving benefits; ill-health benefits; pension commencement lump sum (PCLS) and interaction with pension income; death benefits before and after crystallisation

3.6.3 Understand the main DC pension accumulation options: main types of DC schemes, their features costs and benefits; the main differences between contract-based and trust-based DC arrangements; employer and employee and other individual contributions – the main methods and issues; switching between DC pension arrangements, safeguarded benefits and pensions consolidation; death and sickness benefits; investment choices and restrictions

3.6.4 Understand the main DC decumulation rules and options in relation to retirement planning for individual customers: flexi-access drawdown; uncrystallised funds pension lump sum (UFPLS); annuity purchase; drawing the whole pension fund as cash; small pots/trivial commutation rules

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A DB scheme provides a guaranteed pension where members are promised specific benefits according to the scheme rules.

Each member of the scheme is normally required to make contributions, but the responsibility of meeting the benefits for the members lies with the employer. This, therefore, means that if the pension fund suffers a fall due to poor investment performance, the employer must meet the additional costs of providing those **retirement benefits**.

DB schemes are also referred to as 'final salary' schemes, but as some now operate on the basis of providing benefits that relate to average earnings over a period before retirement, (eg, the NHS scheme), or average earnings over the whole of a member's employment, they are also referred to as 'career average' schemes. This can reduce the scheme's liabilities at times when earnings rise sharply.

A scheme may change the level of employee contributions and it may also have to change the level of employer contributions as a result of:

- investment performance and its effect on scheme assets
- changes in the demographics of scheme members, including mortality rates
- impacts of salary level changes, and
- regulatory or legal changes.

7.1 Member Benefits of DB Schemes

- DB pensions are generally index-linked.
- A tax-free lump sum can be taken as part of the pension at retirement.
- If a member dies while in service, their beneficiaries receive a lump sum as well as a dependant's pension.
- If a member is unable to work due to serious illness, early retirement may be possible.
- Employer contributions to the member's retirement pot are a valuable benefit.

7.2 Hybrid Schemes

A typical 'hybrid arrangement' is one which offers **money purchase benefits** but underpins a member's entitlement with a minimum defined benefit. There are other variations, but whatever the options, only one type of benefit will ultimately be provided.

Normally, at the point benefits are drawn or entitlement arises under a hybrid arrangement, it ceases to be a hybrid arrangement, and will either be treated as a money purchase arrangement or a 'defined benefits arrangement'. If the benefits provided are money purchase or cash balance benefits, then the arrangement will become a money purchase arrangement. Similarly, if the benefits provided are defined benefits, then the arrangement will become a defined benefits arrangement.

7.3 Career Average Schemes

Rather than being based on the final salary, these schemes offer a pension income using average earnings over an individual's career. Members build up a fraction (known as the 'accrual rate') of their career averaged revalued earnings for each year of membership of the scheme.

These have been used more by employers as a way of reducing their pension liabilities.

7.4 Rules and Operation

A DB scheme is governed by a trust and the trustees hold the trust property for the benefit of the scheme members.

The trustees have a duty to manage the scheme in accordance with law and the requirements of the relevant legislation (the Pensions Act 1995 and the Pensions Act 2004).

The pension scheme will have its own set of rules and will include key information, such as the following:

- **The normal retirement age (NRA)** – this is the age at which the member stops contributions and usually takes benefits (although you should note that a member does not actually have to retire in order to take scheme benefits). The NRA for most schemes is 65 or 60.
- **Eligibility to join the scheme** – the scheme rules specify who is eligible to join and when. Some schemes have different categories of membership and different levels of benefits for each of those categories. It is quite common for a scheme to have a minimum age of membership and a probationary period of employment before they can join the scheme. The period of service is, therefore, the member's period of scheme membership rather than the length of time they have been an employee.
- **Employer contributions** – employers have an open-ended obligation to provide pension benefits to employees. The cost involved in providing these benefits means the employer must make contributions, usually annually, to the scheme. The scheme's actuary calculates the funding rate, which is the level of regular contribution needed, and this is reviewed at least once every three years.
- **Accrual rate** – the scheme rules define the rate at which scheme benefits accrue for each year of pensionable service. For example, 1/60th of pensionable remuneration for each year or of pensionable service up to a maximum pension of 40/60ths.
- **Pensionable remuneration** – some schemes will use the basic salary as the figure when calculating retirement benefits; however, other schemes may include, for example, bonuses, overtime and commission.

Example

Charlie is approaching the normal retirement age of his company's DB pension scheme. He has been a member of the pension scheme for 20 years. His final pensionable remuneration is £40,000 and the scheme has an accrual rate of 1/60.

Charlie's pension entitlement can be calculated as:

20/60 x £40,000 = £13,333.33

7.5 Funding Issues

The cost of running DB pension schemes has risen which has, in turn, caused companies to change to, or consider changing to a DC arrangement.

The factors that have affected the cost of DB schemes include:

- increased longevity, meaning scheme members generally living longer
- falls in the value of pension funds, and
- more stringent regulation, such as the need to meet statutory funding objectives.

Scheme funding requirements came into force as a result of the Pensions Act 2004. Trustees have duties and obligations to monitor the payment of contributions and to report significant payment failures to the regulator and to members.

An actuarial valuation must be carried out by the trustees annually or, if they prepare actuarial valuations in the interim, every three years.

An actuary has to certify the calculation of technical provisions produced within 15 months of the actuarial valuation's effective date.

A review and revised statement of funding principles (SFP) has to be done within 15 months of the actuarial valuation. This sets out the trustees' policy for meeting the statutory funding objective and must be agreed with the employer.

The trustees must set in place a recovery plan if the statutory funding objective is not met.

7.6 Employer Covenant

The employer covenant represents the extent of the employer's obligation and financial ability to support the pension scheme not only now but also in the future. The trustees of the scheme need to understand the strength of this covenant today and how it can develop in the future.

An assessment of the employer covenant should be undertaken at each actuarial valuation.

7.7 Top-Up Options

Occupational schemes usually offer the ability to top up pension benefits through **additional voluntary contributions (AVCs)**. This is usually offered through one of two methods, which are discussed below.

7.7.1 On an Added-Years Basis

This is where it is possible to use AVCs to buy added years of service in the main scheme.

The scheme actuary makes a calculation of what it would cost to buy one additional year of service, using assumptions of salary growth and fund growth rates. They are likely to be 'conservative' in their assumptions to ensure that the cost of providing the guaranteed benefit is not more than the AVCs being paid and the growth on these.

Benefits are usually paid in line with the rules of the DB scheme and can normally only be taken at the same time as the main scheme benefits.

AVCs that are used to buy added years often suit those employees who are expecting their future salary to increase quickly.

7.7.2 AVCs on a Defined Contribution Basis

This is where the employer may have set up a scheme to receive AVCs or they may have a group personal pension arrangement in place. The member's AVC will be paid into a fund that is invested until retirement when it is then used to pay an additional pension for the member.

7.8 The Role of Trustees

As mentioned, a DB scheme is set up under a trust and the trustees hold the trust property for the benefit of the scheme members. Trustees must be over 18 and of sound mind; they should have a thorough understanding of trust and pensions law, as well as knowledge of occupational pension schemes. There is a requirement for trustees to maintain their knowledge, particularly in the face of changing pension legislation and/or regulatory developments.

7.8.1 Trustees' Duties and Responsibilities

Pension trustees have a duty to act in accordance with the trust deed of the scheme and with regard to their responsibility to members; these duties fall into the category of general duties, together with acting prudently and honestly.

7.8.2 Contributions

Trustees must ensure that the employer pays the right amount of contribution and in a timely manner. If this does not happen, the trustees must take action.

The rules are as follows:

- Contributions deducted by the employer from employees' pay must be paid into the scheme no later than 19 days from the end of the month that they relate to.
- Any contributions made by the employer must be made in accordance with the schedule of contributions for a DB scheme or the payment schedule for a DC scheme.
- Should a rule breach occur, scheme members need to be informed. If the breach is likely to have a significant effect on the scheme, the trustees or scheme managers must report this to TPR.

7.8.3 Payments to Members and Records Kept

The employer must pay the correct benefits to the correct members in a timely manner, and a proper annual report (see point below) with an auditor's statement must be prepared. Trustees must ensure that minutes of trustees' meetings and decisions made are kept together with relevant details of all transactions and members, past and present. Members must also receive regular statements detailing their benefits.

7.8.4 The Investment Fund

The trustees must ensure that the fund has been invested prudently, and in line with the stated investment styles and all legal and regulatory requirements.

7.8.5 Professional Advice

This must be obtained by the scheme; trustees must make sure this happens and that it is from suitably qualified specialists for each relevant area of investment.

7.8.6 Registering and Paying the Levy

Trustees have to register the pension scheme with TPR and provide certain information about the scheme as well as ensuring that the annual payment to TPR is made.

7.8.7 Reporting to TPR

There are circumstances where trustees must report matters to TPR, for example persistent failure by the employer to pay contributions in accordance with the current schedule of contributions, where the contributions remain unpaid.

There are also circumstances where the scheme's professional advisers are required by law to consider reporting trustees, employers or other professional advisers to TPR.

7.8.8 The Annual Report

A scheme annual report must normally be made within seven months of the pension scheme year end. Such a report includes the audited accounts with an auditor's report into the scheme, comments from the investment managers, and key legal and administrative information provided by the trustees.

7.9 Trustees' Liability

As with any other type of trust, pensions trustees can be held personally, jointly and severally liable should a loss occur in the scheme as a result of a breach of trust, acting without proper authority, failing in one or more of the duties highlighted above or through deliberate negligence. The employer may offer trustees insurance to protect their personal assets. Many schemes also have rules which protect trustees unless they breach scheme rules deliberately.

7.10 The Role of Other Parties

In addition to regulatory bodies, a variety of other parties have responsibilities to protect the benefits of members of schemes; these include pension scheme trustees, financial advisers, investment firms and employers.

7.11 Scheme Reporting

We have touched on the issue of reporting pensions deficits in a firm's accounts and the possible effect this has had on the provision of DB schemes. It is important to note that, in terms of transparency, what is still missing is the reporting of pension buyout costs. This is where companies pay a fixed amount to transfer pension scheme risk to an insurer. Without this on a firm's accounts, the danger of inappropriately risky investment actions remains.

Pension scheme liabilities have an effect on corporate credit ratings, making it more difficult for the employer to obtain credit and making credit more expensive. On the other hand, one could argue that, ultimately, the pension deficits exist and the employer is responsible for meeting these and, therefore, it is correct and transparent for the company to have these represented in their accounts. One area of

concern is that credit ratings agencies may actually underestimate pension risk in debt-rating estimates, as they did in the sub-prime mortgage scandal.

7.11.1 The Scheme Actuary

The scheme actuary is appointed by the trustees and their role includes:

- actuarial valuation, such as funding requirements
- surplus statements
- certification of the contributions payable
- certification of individual transfers
- certification of employer debt on winding up
- certification of (bulk) transfers in the case of mergers and acquisitions, and
- provision of professional advice and guidance on pension issues, such as potential benefit payments, the funding position and how to balance the interest of all the various parties.

7.12 Retirement Options from DB Schemes

When a member reaches the normal retirement age, they will be entitled to their pension benefits based on their years of service, their pensionable salary and the scheme's accrual rate.

Pension income is taxed as earned income, and some or all of the pension will escalate each year in payment. There are statutory minimum rates of escalation; however, a scheme can pay more than this if they wish.

Different levels of increase apply to the guaranteed minimum pension (GMP); this is the minimum pension a scheme has to provide for those who were contracted out of the ASP.

7.12.1 The Pension Commencement Lump Sum (PCLS)

As well as an annual income, schemes can offer a separate lump sum or the annual pension income can be commuted (reduced) for a lump sum.

For example:

- Scheme A has an accrual rate of 3/80ths multiplied by the number of years' service of final pensionable salary to calculate the lump sum.
- Scheme B has a commutation rate of 12:1 which means that for every £12 of PCLS taken, the annual income is reduced by £1.

Example

Marcus is about to retire. He has been a member of his employer's DB scheme for 20 years and his final salary is £40,000. The scheme operates as a 1/60th scheme.

Marcus is entitled to a pension of 20/60 x £40,000 = £13,333.33

Marcus can take the £13,333.33 as pension income, or he can commute part of this for a PCLS of 3/80th of his salary for each year of service. The commutation factor is 12:1.

Marcus will have a reduced pension, plus a tax-free lump sum calculated as follows:

PCLS = 20 x 3/80th x £40,000 = £30,000

The reduction in his pension is £30,000/12 = £2,500

£13,333.33 – £2,500 = £10,833.33.

7.12.2 Early or Late Retirement

Most schemes allow members to retire early. In these circumstances, their benefits are calculated at the date of early retirement and reduced by an actuarially calculated early retirement factor.

Schemes can also allow members to retire after their normal pension age. In these circumstances, a late retirement factor will be applied, which would result in an increased pension being payable.

7.12.3 Ill Health Early Retirement

Scheme rules may allow early retirement on the grounds of ill health to those aged below 55. The scheme rules will dictate how benefits are calculated and it is common for early retirement reduction factors to be ignored.

If a member has a life expectancy of less than 12 months, then the whole pension can be commuted for a lump sum. This will be tax free if it is below the member's remaining lump sum allowance & death benefits allowance.

7.13 Death Benefits

Schemes can pay a lump sum to the member's beneficiaries on death in service. The lump sum would be free from tax provided it is within the member's lump sum and death benefits allowance. From April 2027, lump sum death benefits will fall within the estate for inheritance tax purposes.

In addition to any lump sum paid to those who die in service there is often a spouse's/civil partner's/dependant's pension. The scheme rules will state how these benefits are calculated, but it is common for 50% of the member's pension to be payable.

If a member dies in retirement, then their full pension would usually be paid for the remainder of any guaranteed period (if included); a spouse's/civil partner's/dependant's pension is then paid as a fixed percentage of the member's pension at the date of death – again, this is usually 50%.

7.14 Scheme Leavers

The scheme rules will detail the options available to those who leave the scheme before normal pension age. There are usually three options:

- **A refund of the member's contributions** – this is normally only available to those who leave with less than two years' membership. If more than three months' service has been completed, then the scheme must offer a transfer value. If a refund of contributions is made, these are taxed as follows:
  - First £20,000 x 20%.
  - 50% on the remainder.
- **Preserved benefits** – normally available when a member has completed at least two years' service. This is known as a 'deferred benefit', and the member will be known as a 'deferred member'. The preserved pension at the date of leaving is revalued each year between the leaving date and the scheme's normal retirement age.
- **CETV** – this must be offered to anyone who has completed three months' pensionable service. The member can transfer their pension away from the scheme into another pension scheme. The figure can be reduced if the scheme is underfunded or, indeed, enhanced if the scheme is looking to reduce their overall liability.

Before transferring a DB pension scheme with a value of more than £30,000, the FCA requires a member to receive 'appropriate independent advice'. This is because the FCA regards DB schemes as 'safeguarded benefits'.

There are many factors to consider before taking the decision to transfer safeguarded benefits, and detailed advice is needed to help the member understand the advantages and disadvantages of such a transfer. To help with this process, it is a regulatory requirement that the firm providing the advice provides the following:

- A **transfer value comparator (TVC)** – this is designed to highlight the value of the benefits the client is giving up. It calculates the capital sum which would be needed to purchase benefits of the equivalent value at the scheme's normal retirement date. This is calculated using assumptions set by the FCA. This value is then discounted back to the date of calculation using a risk-free rate of return, which is again set by the FCA. The resultant figure is compared in bar chart form to the transfer value on offer from the scheme. The purpose of this is to demonstrate the returns required, over and above the risk-free rate, to match the capitalised value of the DB entitlement at retirement.
- An **appropriate pension transfer analysis (APTA)** – designed to set out clearly to the client the benefits, drawbacks and risks of both the ceding DB and replacement personal pension. The analysis should attempt a full comparison of the options available from each and unequivocally set out why the replacement scheme meets the client's needs more fully. Some of the factors considered may include amount and shape of income, lump sum requirements, death benefits, risk profile, scheme protection, flexibility and tax position.

As a part of the TVC, the firm may consider the critical yield. This was formerly a requirement under the previous Transfer Value Analysis Service (TVAS) system, though it is no longer compulsory. The critical yield is the annualised return after deduction of charges which would be required in order to generate a lump sum sufficient to purchase benefits matching the scheme ones.

The critical yield is only going to be accurate if all the assumptions become a reality; however, together with the TVC and the APTA, it can help to put into context the fact that transferring from a DB scheme to a DC arrangement moves the investment risk from the employer to the member.

If the member has a low appetite for risk, and is a very cautious investor, a critical yield of 10% is likely to result in the advice being to stay in the scheme. Term to retirement is also an important factor as the longer the member has to invest, then the more likely they will achieve a higher return from equity-based investments.

Those in ill health may wish to transfer from a DB scheme to access their benefits flexibly, purchase an enhanced annuity or gift their pension to their family. However, this needs to be considered alongside the scheme rules which might allow those in serious ill health to fully commute their pension benefits.

7.15 Public Sector Schemes

Each public sector scheme (also known as a public service scheme) has rules which set out details of the membership and the benefit provided.

Public sector schemes are those covering:

- civil servants
- local government workers
- teachers
- health service workers
- fire and rescue workers
- members of police forces, and
- members of the armed forces.

The only scheme that is funded is the local government pension scheme. The other schemes are all unfunded and, for this reason, they are not able to transfer their benefits to access the new flexible benefits.

The Pensions Schemes Act 2015 allows the reduction of the transfer value where benefits are transferred from a funded public sector scheme to obtain flexible benefits.

7.16 Defined Contribution (DC) Schemes

In complete contrast to a DB scheme, DC (or money purchase) schemes offer no guarantees as to the amount of pension income a member will receive.

Instead, a fund is built up to which contributions are made and it is the contribution that is defined rather than the eventual benefit.

An individual who becomes a member of a DC scheme must be aware that they take on all the investment risk; their eventual pension income will be totally reliant on the amount of contributions made and investment returns.

Types of DC pension schemes are examined below.

7.16.1 Group Personal Pension (GPP) Schemes

A group personal pension (GPP) is set up by an employer but, instead of being an occupational scheme, it is actually a collection of personal pension plans, with each employee owning one of the plans. The advantage of grouping them together is that administration costs are lower for both the employer and for the individual members.

A trust is not needed as the employer has no access to the funds within the pension scheme; however, the employer is still able to set out the requirements for joining, and set out the amount of employer and employee contributions required.

Contributions made are split into each employee's individual pension and invested in a fund chosen either by the employer or by the employee. Typically, the employee will be given a list of funds from which to choose.

GPPs provide employees with flexibility, as the plans can be taken with them if they were to change employers. Also, as the contract is directly between the employee and the pension provider, the employee can choose their own retirement age.

7.16.2 Personal Pension Plans (PPPs)

Personal pension plans (PPPs) are arranged by an individual and have historically been used by those who are self-employed and do not have access to an employer scheme.

Benefits build up in the same way as with any other money purchase scheme and they depend on the number of contributions paid in and how the fund invested in has performed. Benefits can be taken from the age of 55, or earlier if the member is in ill health.

7.16.3 Stakeholder Plans

These are a type of personal pension introduced by the government to encourage pension savings by placing a limit on charges and setting low minimum premiums. They can be taken out by someone who is employed and already has a workplace pension, by someone who is self-employed, or even by someone who is not working.

The charge is restricted to an annual management charge (AMC), and the rate depends on when the member joined the scheme membership:

- **Prior to 6 April 2005** – maximum charge is 1% of the fund value.
- **Post-5 April 2005** – maximum charge is 1.5% for the first ten years and 1% thereafter.

The minimum contribution to a stakeholder pension is £20 net; this can be paid at any time, either as a regular contribution or as a one-off payment.

Contributions can be invested in a range of funds. However, if the individual does not want to decide which fund to invest in, they can choose a 'default' fund and within this it will be possible to opt for 'life styling'. This is an investment strategy where the member's fund is automatically moved away from riskier investments, such as equities, into lower risk investments, such as gilts and cash; it is usually around five years before their expected retirement date.

7.16.4 Retirement Annuity Contracts (RACs)

Retirement annuity contracts (RACs) were the first type of personal pension. Despite the fact that it has not been possible to take out a new RAC since 1 July 1988, contracts will still be in existence and contributions can still be made to them. They were also known as Section 226 contracts.

The personal pension replaced RACS in 1988. Although they are very similar contracts, some RACS offered a guaranteed annuity rate which may be higher than the rates available on the open market.

7.16.5 Section 32 Buyouts

Section 32 of the Finance Act 1981 enabled pension scheme trustees for the first time to transfer company pension scheme funds to a private arrangement. Prior to A-Day, the scheme allowed them to take advantage of the same benefits as the original company scheme, with the additional control of a personal pension.

However, today, a Section 32 policy cannot accept further contributions or any other transfers.

Note that while S32 is still used as a 'short hand' descriptor, Section 32 of the Finance Act 1981 has been repealed, so effectively new 'S32' plans are not possible.

They were useful if the occupational pension was being wound up or if the employee had left employment and wanted to transfer to a contract that was not a personal pension. The main reasons someone would have transferred to a Section 32 contract rather than a personal pension was that:

- They were governed by occupational pension rules which meant that, in some cases, higher tax-free cash could be taken.
- The GMP was still secure within the contract, meaning that the Section 32 had to guarantee to pay at least the GMP from the previous scheme.

However, if the scheme does not offer the new pension flexibilities, the individual may need to transfer when it comes to draw the benefits – though this may have an impact on any protected tax-free cash and the GMP safeguarded benefit.

7.17 Self-Invested Personal Pensions (SIPPs)

A **self-invested personal pension (SIPP)** is a type of personal pension and works in much the same way. The main difference is that there are wider investment opportunities, which is useful for those who wish to manage their own fund and investments. For example, a SIPP can invest in direct shares and commercial property. The contribution limits, tax rules and retirement options are the same, however.

To facilitate wider investment opportunities, a SIPP can borrow up to 50% of the net scheme assets.

If a SIPP has net assets of £200,000, it can borrow a further £100,000 for investment purposes. This facility is often used to buy commercial property for the individual to trade from; an additional advantage of this is that businesses will pay rent to the SIPP further enhancing the value of the fund.

A SIPP can also become value added tax (VAT) registered. VAT is then added to the rents charged, however, this means that the high costs of materials for building commercial property or professional fees are eligible for the VAT to be reclaimed.

7.17.1 Small Self-Administered Schemes (SSASs)

Just as SIPPs are a derivation of PPPs, **small self-administered schemes (SSASs)** originally started as a derivation of executive pension plans (EPPs) which were generally set up as a one-man scheme for company directors.

SSASs were marketed to the same type of companies, but with the added extras of self-investment options and the borrowing facility.

A SSAS is a type of occupational pension scheme, typically with fewer than 12 members, where all members are trustees and have control over the scheme's assets and decisions.

Just as with SIPPs, SSASs can borrow up to 50% of the net scheme assets. Often, this may be used for the same purpose of bringing a company's commercial property under the ownership of the pension scheme, with the resulting tax benefits that the pension scheme attracts: no corporation tax on sale; tax-free growth on property value, and rental goes into pension fund.

Unlike SIPPs, SSASs can also lend money from the scheme to the **sponsoring employer** without tax penalties. There are certain conditions which must be met, including:

- no more than 50% of the scheme assets can be lent
- the SSAS must charge interest at a minimum rate of 1% over the average base rate, and
- the maximum term of the loan is five years, which may be rolled over only once.

If any conditions are not met, the loan will be an unauthorised payment which could, ultimately, result in the SSAS being deregistered.

SSASs can invest in the sponsoring employer, although the extent of this investment has been limited since 'A-Day'. Now, a SSAS can only invest up to 5% of scheme assets in any one sponsoring employer, and under 20% of scheme assets where the shareholdings relate to more than one sponsoring employer.

7.17.2 Uses of Self-Invested Options

Investors who use self-invested options to invest in diverse and risk-appropriate assets can benefit greatly from self-investment. The possibility of getting the business premises from which they operate under pension funding rules is certainly attractive, and makes sense for many. Also, if an individual has a portfolio of shares and bonds, a SIPP provides a tax-efficient wrapper for them.

However, there are dangers in self-investment. It is a high-risk approach, for example, for an individual to invest heavily in the shares of their own company, as they are then relying on that company for income in retirement as well as during their working life. It should also be remembered that unlisted shares are particularly illiquid.

7.18 Trust-Based and Contract-Based Money Purchase Schemes

DB schemes are always set up under a trust.

A money purchase scheme, however, can be set up either as a trust-based scheme or as a contract-based scheme.

With a trust-based scheme the assets are governed by a trust and the trustees – rather than the employers providing the scheme holding the scheme's property.

Although the trustees are appointed by the employer, they act independently for the benefit of members. Part of their duties is to set out some of the initial information in the trust deed, including retirement age and who can join the scheme. The employer simply agrees what level of contribution the company will make, and it is part of the trustees' role to ensure that the payments are made. Schemes set up in this way are generally expensive for an employer to run.

Contract-based schemes are set up by insurance companies, and the main relationship is between the member and the provider. There are no trustee responsibilities. Schemes set up in this way are generally less expensive to run for the employer.

The benefits that can be provided are generally the same from both types of schemes.

7.18.1 Advantages and Disadvantages

The advantages and disadvantages of money purchase schemes can briefly be summarised as follows:

Advantages

- The employer has control over pension liabilities.
- The commitment to make payments is only as much as the funds available rather than a deficit situation arising out of the employer's control.
- If better than expected investment performance is achieved, the employee benefits could be better than expected.
- Lower running cost compared to DB schemes.
- Less complexity for transferring in other DC pension benefits so helps when a mobile workforce is suitable.

- Employer – limited liability compared to a DB.
- Employees have no lock-in to the employer so there is flexibility to move the pension to a new employer.

Disadvantages

- No guarantee of a defined pension benefit for the member as to what their pension will be; it all depends on the contributions and investment growth of the pension fund.
- Challenges for the individual to plan for retirement when the final pot is unknown and dependent on investment performance.
- Individual and detailed statements required for each member.
- Less likely to encourage employee retention.
- For the member, there is greater uncertainty and greater exposure to risk in planning for retirement.

7.18.2 Contributions

Individuals can make any contribution they like to a personal pension – the only thing that is restricted is the amount of tax relief that will be received.

If someone has no earnings, they can still make gross contributions of up to £3,600 pa and receive basic rate tax relief on the contribution.

Minimum employee contributions are usually set by the employer as a condition of membership. If someone wishes to pay more, the employer may match the extra amount.

Employer contributions will also be set usually as a percentage of earnings – although if the scheme is being used for auto-enrolment purposes, it must satisfy the minimum contribution requirements.

The employer will also define what is meant by earnings and could exclude overtime, bonuses or the value of benefits in kind.

Example

Sonia is a member of her company's occupational DC scheme. She earns £30,000 pa and receives an annual bonus of £10,000.

Sonia's employer contributes 5% of pensionable earnings, and Sonia must contribute 4%. Pensionable salary is defined as basic salary only.

Therefore, the employer pays £30,000 x 5% = £1,500 pa and Sonia pays 4% x £30,000 = £1,200.

7.19 Taxation of Lump Sums on Death

Any individual can inherit unused drawdown funds or uncrystallised money purchase funds on the death of the member, where those funds are used to provide a drawdown pension or to pay a lump sum death benefit.

For someone who is not a dependant, there is a nominee's FAD fund. In addition, any beneficiary (ie, a dependant or a nominee) with unused drawdown funds on their subsequent death can pass those funds to a successor; the funds can then be designated to provide a drawdown pension for that individual (a successor's FAD fund), or they can be paid as a lump sum death benefit. Any number of beneficiaries may be nominated.

The age at death determines how pension death benefits are treated for tax.

7.19.1 Death before 75

A member can nominate any individual and payments to that individual will be made free of tax, whether taken as a lump sum or accessed through drawdown, providing that the funds are designated within a two-year period. Payments structured as a lump sum are also subject to the lump sum and death benefits allowance.

Pension benefits must be designated to an income-producing contract (drawdown or annuity) or paid out as a lump sum death benefit within two years of the scheme member's death. Otherwise, funds will be taxed at the beneficiary's marginal rate.

The pension fund can be taken tax free, at any time, and either in instalments, or as a one-off lump sum. This will apply to both crystallised and uncrystallised funds.

Note that these rules do not apply to dependant's annuities and scheme pensions (ie, where the pension is paid directly out of the scheme assets or paid by an insurance company selected by the scheme administrator). These will continue to be taxed at the beneficiary's marginal income tax rate.

Note also that as of April 2027, inherited pensions will become subject to inheritance tax.

7.19.2 Death after 75

DC pension savers will be able to nominate who 'inherits' their remaining pension fund. This fund can then be taken under the pension flexibility regime and will be taxed at the beneficiary's marginal rate as they draw income from it. Alternatively, they will be able to take the fund as a lump sum, less a tax charge based on the respective beneficiary's marginal income tax rate. There is no test against the lump sum and death benefits allowance where the member dies after the age of 75.

Taking pension benefits below age 55 is possible if an individual is in ill health. The Finance Act 2004 sets out the definition of 'ill health', which a scheme must consider when a member requests their benefits on these grounds.

If the member's life expectancy is less than one year, then it is possible for them to commute all their uncrystallised pensions for a serious ill health lump sum, subject to the lump sum allowance. From 6 April 2024, the Lifetime Allowance (LTA) has been abolished. Instead, tax-free lump sum payments are subject to a new Lump Sum Allowance (LSA) and Lump Sum and Death Benefit Allowance (LSDBA).

Where a member is over 75, the whole sum is taxed as income under PAYE. Again, from April 2027, there will also be an inheritance tax charge applied, which could significantly reduce the value of the pension fund passed on.

7.19.3 Flexi-Access Drawdown (FAD)

Flexi-access drawdown (FAD) was introduced as part of pension flexibilities in 2015 and is an option available for someone with a money purchase arrangement.

If someone in a DB scheme wishes to benefit from FAD, they would need to transfer out of the scheme into a money purchase plan.

New drawdown arrangements set up since 6 April 2015 are flexi-access, and members can choose to go into FAD from age 55, or earlier through ill health.

Note that designating funds into FAD does not trigger the MPAA, but as soon as the member takes an income withdrawal from the FAD fund, the MPAA will be triggered for that particular tax year and for all subsequent tax years.

There are no restrictions on the number of withdrawals that can be taken in FAD. Any PCLS that is taken at the outset is tax free, and further withdrawals are taxable as pension income under PAYE.

7.20 Uncrystallised Funds Pension Lump Sum (UFPLS)

If a member has reached age 55 (or meets the ill health conditions), an UFPLS can be paid from uncrystallised money purchase funds as a lump sum; 25% is tax free, and the balance is taxed at the member's marginal rate of income tax.

Example

Mitchell is aged 58, has a money purchase fund with a value of £100,000. He wishes to take the whole fund as a lump sum, and this will be his only income in this tax year.

£25,000 will be tax free.

£75,000 will be taxed at his marginal rate of income tax.

£12,570 will be taxed at 0%.

£37,700 will be taxed at 20% = £7,540.

£24,730 will be taxed at 40% = £9,892.

£75,000 – £17,432 = £57,568.

Mitchell will be left with the tax-free amount of £25,000 + net payment of £57,568 = £82,568.

However, if the provider does not have a tax code, the UFPLS will be taxed on a 'month one' basis. This means that the payment is taxed as if it is a monthly payment rather than a one-off payment. 1/12 of the personal allowance is applied, as well as 1/12 of the income tax bands, with the result that too much tax is paid, and which will need to be reclaimed.

A member can decide to take the whole pot as a UFPLS, or take it as a series of smaller lump sums.

Payment of a UFPLS does, however, trigger the MPAA.

It is not possible for a member to have a UFPLS, if they have:

- enhanced protection/primary protection with tax-free cash of more than £375,000, or if they have scheme-specific PCLS of more than 25% of the fund value, or
- an LTA enhancement factor and the lump sum is less than 25% of the proposed UFPLS.

Remember also that a UFPLS is from uncrystallised funds, not crystallised funds.

7.20.1 Annuity Purchases

For some, purchasing an annuity with money purchase funds is still an attractive option – particularly those who require a guaranteed income, or who have a low attitude to risk and/or capacity for loss.

An annuity can be bought from either uncrystallised funds or from funds held in drawdown.

The annuity rate will depend on the member's age, and whether they require any particular options, such as a guarantee period or survivor's benefits; the amount of income will depend on the size of the accumulated fund.

Since 2015, it has been possible to purchase a lifetime annuity that offers flexible payments.

For a number of years following the announcement of the pension freedoms in 2015, annuities fell massively in popularity. Very low interest rates made them often poor value and with the opportunity to take income flexibly and leave any unused fund on death free of inheritance tax, flexi-access drawdown became the new normal.

Following the rapid increase in interest rates as a result of the inflation crisis, annuity rates have become more attractive again and we have seen an increase in the number of people purchasing an annuity. The FCA's retirement income market data shows that the number of annuity purchases increased from 59,163 in 2022-23 to 82,061 in 2023-24. It is possible that this will continue to increase in future as the addition of inheritance tax to unused pension pots serves to reduce the attractiveness of flexible access to benefits.

7.20.2 Drawing Whole Fund as Cash

Since it is now possible to withdraw a whole pension pot in one go, it is important to be aware of the risks of doing so.

Firstly, the tax bill could be significant: 25% will be tax free, but the remaining 75% will be taxed at the individual's highest marginal rate.

Other considerations include:

- running out of money in retirement
- taxation possibly increasing, and
- the fact that it cannot be reversed.

Drawing the whole fund as cash is certainly one option, but it is important that the client is aware of all the options available before they go down this route. It would not generally be recommended other than for relatively small funds due to the tax implications and sustainability considerations.

7.20.3 Leaving Benefits

Until 1 October 2015, a refund of the member's contributions from occupational DC schemes was only available to those with less than two years' membership. The refund of a member's contributions will be taxed at 20% on the first £20,000, and 50% on the remainder.

Short service refunds are no longer allowed.

Since 1 October 2015, occupational DC schemes must offer a short service benefit where a leaver has at least 30 days' **qualifying service**.

7.20.4 Preserved Benefits

In a DC scheme, the value of the fund, including all employer and employee contributions, is the preserved benefit.

The member can leave the pension alone until they wish to access it, or they can transfer it to an alternative arrangement. If the member is close to retirement, a major factor that may influence their decision to transfer or not is the range of income options that the scheme offers. For example, not all schemes will offer FAD and, if this is how the member wants to access their pension, then they will need to transfer their scheme to a more flexible arrangement that offers it.

7.20.5 Triviality and Pension Small Pots Payments

A small pot payment can be taken from any arrangement, irrespective of the overall value of the individual's pensions.

Up to three small non-occupational pensions (such as personal pension plans) can be commuted under small pots payments, but there is no limit on the number of occupational pensions that can be taken under small pots. The following conditions need to be fulfilled to allow the payment to be commuted as a small pot:

- The member has reached the minimum retirement age of 55 (or satisfies the ill health rules).
- Each payment does not exceed £10,000 at the time that it is paid to the client.
- The payment extinguishes all member benefit entitlement under the arrangement.
- Small pots apply at arrangement level rather than at scheme level. So, the payments can be made from two/three separate registered pension schemes or from the same scheme where the payments are made from two/three different arrangements under that scheme.
- With regard to non-occupational pensions (such as personal pensions) only, the maximum of three small pot payments is not exceeded.

Please note that small pots do not trigger the MPAA. They are also not tested against the lump sum or lump sum and death benefits allowances.

The first 25% of the lump sum will be tax free, with the balance being taxed as pension income.

Trivial Commutation

Triviality payments apply to a DB scheme, or to an in-payment money purchase scheme pension which is paid directly from scheme assets. The following conditions must be complied with:

- the member has reached the age of 55 (or satisfies the ill health conditions)
- all benefits selected are extinguished by the commutation, and
- the value of all members' rights should not exceed £30,000 on the nominated date.

The first 25% of the lump sum will be tax free, with the balance being taxed as pension income.

8. State Retirement Benefits

Learning Objective

3.7.1 Understand the structure, relevance and application of the state schemes in relation to an individual's pension planning: basic state retirement benefits; structures, state retirement ages (SRA), levels of benefit, link to national insurance records and SRA; Pension Credit framework; other relevant state benefit entitlements

8.1 State Pensions

As we have already seen, providing a state pension has become increasingly costly for governments due to increased numbers in retirement, compared to those of working age, and increased life expectancy.

As a result of this, we have seen changes to the SPA, as well as to the BSP. Prior to 2016, it was possible for employees to build up an ASP in addition to a BSP; this has now been abolished. Since 2016, the state pension is a new amount and is solely dependent on an individual's NIC record.

The earliest age that state pension can be claimed is the SPA which has been changing since 2010. The SPA is currently 66 and due to rise to 67 by 2028 and then 68 for both men and women. A regular review period of five years was introduced. The first of these took place in 2017, and the resulting report recommended that the SPA be increased to 68 between 2037 and 2039 which has been brought forward from previous recommendations. There are plans to change SPAs even further in the future.

8.1.1 The Basic State Pension

Those individuals who reached SPA before 6 April 2016 will continue to receive the BSP.

How much an individual receives depends on how many years of NICs they have made over their working lifetime. To qualify for the full amount of BSP, 30 years' contributions are required – these are built up either by working, being credited while caring for a family, or voluntarily paying to make up missed years. To pay NICs, individuals must earn over the primary threshold (£242 per week for 2024–25). Individuals are credited with NICs if they earn over £123, but less than £242 per week.

The most common examples of NIC credit are:

- receiving certain state benefits, such as statutory sick pay, statutory maternity pay, or jobseeker's allowance (JSA)
- being in full-time education between age 16 and 18 (note, university years are not credited)
- unemployed men born before 6 October 1953 (without the need to sign on to receive JSA), and
- individuals may now be credited with having paid NICs, if they are:
  - incapable of work because of illness or disability
  - receiving carer's allowance
  - receiving working tax credit
  - doing jury service
  - serving a prison sentence for a conviction, which was subsequently quashed, and
  - parents looking after children up to the age of 12, and carers who provide at least 20 hours of care per week.

A higher amount may be paid if there is an entitlement to ASP (ie, graduated pension, **State Earnings-Related Pension Scheme (SERPS)** or the **state second pension (S2P)** that was accrued prior to 6 April 2016).

8.1.2 The State Graduated Pension Scheme

This was a first attempt to compensate employees for the additional NICs that they paid, compared with self-employed workers, by providing an ASP; it was in place from April 1961 to April 1975 and it was an earnings-related pension which was intended to top up the BSP.

If the member reaches SPA after 5 April 2013, for every £7.50 of graduated contributions paid by a man and £9 paid by a woman, the member will receive £0.1783 (2025–26).

8.1.3 The State Earnings-Related Pension Scheme (SERPS)

SERPS was also an employee-only scheme. It was introduced in 1978, and ran until April 2002.

Employees who were eligible for SERPS were those who earned over the lower earnings limit (LEL). The benefit itself was then calculated on an individual's earnings between the lower earnings limit and the upper earnings limit (UEL), sometimes referred to as 'middle band earnings'.

The original benefit was set at 25% of revalued middle band earnings, with an individual's best 20 years of earnings counting.

It soon became clear that this was too generous and so, in 1988, it was announced that those eligible employees retiring after April 2000 would have their SERPS benefits reduced to 20% of revalued middle band earnings, with lifetime average middle band earnings counted. The percentage benefit was reduced on a sliding scale from the 25% figure before April 2000, to 20% for those retiring after April 2000.

8.1.4 The State Second Pension (S2P)

In April 2002, the S2P replaced SERPS; this was more generous than SERPS and also extended eligibility. Employees who earned over the LEL were still eligible, but so also were carers (who met certain requirements), and those entitled to state benefits as a result of disability.

S2P was earnings-related (similar to SERPS). To ensure that the principal aim of the government was met, ie, that low and non-earners received a greater benefit from S2P, there were originally three bands of accrual. To accommodate three bands, a low earnings threshold (LET) and a secondary earnings threshold (SET) were introduced in addition to the LEL and the upper earnings threshold (UEL) that were used for SERPS.

The three bands of accrual were:

- **Band 1 – LEL** to the LET – benefit accrued at 40% (twice that of SERPS)
- **Band 2 – LET** to the SET – benefit accrued at 10% (half that of SERPS)
- **Band 3 – SET** to the UEL – benefit accrued at 20% (the same as SERPS).

From 6 April 2010 to 5 April 2012 there were only two bands:

- **Band 1 – LEL** to the LET – benefits accrued at 40%
- **Band 2 – LET** to the upper accrual point (UAP) – benefits accrued at 10%.

The aim of S2P was to help the lower-paid, certainly in comparison with the SERPS benefit. The key to this was the introduction of an LET, a notional figure of earnings used for those earning above the LEL but below the LET.

From 6 April 2012, the accrual under Band 1 became a flat rate and under Band 2 accrued at 10% between the LET and the UAP.

8.1.5 The New State Pension

The new state pension was introduced in April 2016. To qualify for the full amount, 35 years of NICs are required either through contributions or credits, known as the 'qualifying years'. Individuals will need ten qualifying years (through contributions or credits) to receive any new state pension.

The full rate of the new state pension is £230.25 per week (2025–26).

Class 1, 2 and 3 NICs will all accrue the new state pension at the same rate.

Individuals who had not reached their SPA on 6 April 2016 had a starting amount calculated. This is known as a foundation amount and is the higher of either:

- the amount they would have received under the pre-6 April 2016 rules (which includes the BSP and the and additional state pension), or
- the amount they would get if the new state pension had been in place at the start of their working life.

Where an individual's foundation amount is lower than the full amount of new state pension, they may be able to increase their state retirement income by adding more qualifying years to their NIC record between 6 April 2016 and their SPA.

Where an individual's foundation amount is higher than the full amount of the new state pension, the difference between their starting amount and the new state pension is called their 'protected payment'.

When the individual reaches their SPA, their protected payment will be paid on top of the new state pension.

The protected payment increases each year in line with increases in the CPI.

In this instance, any qualifying years achieved after 5 April 2016 will not add anything more to the individual's state pension.

Under pre-6 April 2016 rules, an individual's ASP is revalued up to the SPA, in line with average earnings; it is then increased in line with the CPI.

Both the BSP and the new state pension are increased annually. The increase is linked to whichever of the following is the highest:

- **Earnings** – the average percentage increase in UK wages during that year
- **Prices** – cost of living increases that year (CPI)
- **2.5%** – fixed-rate increase.

This is known as the 'triple lock' guarantee. As noted previously, for the 2022–23 tax year alone, the average earnings element of the triple lock was temporarily suspended.

8.2 State Pension Credit

State pension credit is an income-related benefit to top up the state pension; it is made up of two elements:

- guarantee credit, and
- savings credit.

They work together to ensure that individuals in the UK receive a guaranteed minimum level of weekly income, although you should note that savings credit is no longer available for those reaching SPA after 6 April 2016.

8.2.1 Guarantee Credit

Guarantee Credit tops up the weekly income to £227.10 for single people and £346.60 for couples (the minimum income guarantee for 2025–26). To qualify for it, individuals must:

- live in the UK
- have reached SPA
- have weekly income below £227.10 if they are single and £346.60 if a couple, and
- if they are a carer, have severe disabilities or certain housing costs, they might qualify for more Guarantee Credit.

When applying for Guarantee Credit, the government looks at the income. This includes state pension income, income from other pensions, income from any jobs, most state benefits and any savings over £10,000.

Some benefits, such as housing benefit, council tax reduction and Attendance Allowance, are not included, nor are personal possessions or homes.

8.2.2 Savings Credit

This is a reward for those with a modest income and who have saved for retirement.

To qualify for the extra savings credit, a person or their partner must have reached state pension age before the 6 April 2016. The government will give people a little extra money to reward them for saving towards their retirement. This comes in the form of 'Savings Credit'.

There are a few criteria you need to meet before you qualify for Savings Credit:

- You must have a minimum income of £198.27 a week if you are single, and £314.34 a week if you are in a couple in 2025–26.
- You or your partner must be 65 or over.
- You must be living in the UK.
- You must have made some provisions for your retirement, like savings or a second pension.

For every £1 over the Savings Credit threshold. 60p is given in Savings Credit.

The maximum Savings Credit per week is £17.30 for a single person and £19.36 for couples.

Protection will be given to these couples who have already been awarded Savings Credit for the period immediately before, and continuing beyond, 6 April 2016.

8.3 Voluntary NICs

Forecasts are available which give an estimate of state pension based on current NICs or credits, and give information on the years where an individual has not contributed enough. This gives them an opportunity to top up either their new state pension or the old BSP.

8.3.1 Class 3 NICs

Class 3 NICs allow an individual to increase their number of qualifying years, thereby allowing them to achieve a higher level of pension.

Normally, top ups can only be made to fill gaps from the last six years.

The weekly rate is £17.75.

People affected by the changes to the state pension, and who reach their SPA after 6 April 2016, until April 2025 to pay any Class 3 NICs for gaps in contribution between April 2006 and April 2016.

8.3.2 Class 3A NICs

Class 3A NICs should not be confused with Class 3 NICs. While both are paid on a voluntary basis, they purchase different types of state pension:

- Class 3A NICs were only available between October 2015 and 5 April 2017. They allowed an individual to purchase a higher level of ASP (ie, the pension paid in respect of SERPS and S2P).
- The new rules from 6 April 2016 do not permit individuals to claim state pension benefits based on a spouse's or a civil partner's NIC record.
- Any qualifying years gained after the introduction of the new state pension will not add further pension on top of this safeguard amount. Any inherited amount would be paid in addition to the safeguard amount.

8.4 Changes to State Death Benefits since 6 April 2016

The Government consolidated payments designed to provide assistance following bereavement into a new benefit, known as the bereavement support payment. This may be payable if a spouse or a civil partner dies on or after 6 April 2017.

To be eligible, the spouse or civil partner who has died must have paid NICs for at least 25 weeks, or died because of an accident at work or a disease caused by work. The recipient must be under SPA and must be living in the UK, or another country that pays bereavement payments.

The amount that the surviving spouse will receive depends on their circumstances. For those receiving or entitled to Child Benefit, the surviving spouse will receive a first payment of £3,500 followed by payments of £350 for up to 18 months.

For those not receiving or entitled to Child Benefit, the surviving spouse will receive a first payment of £2,500 followed by payments of £100 for up to 18 months.

The payment must be claimed within three months of the death; however it will still be payable if claims are made up to 21 months, however the payments will be reduced.

Remarriage/re-partnering before the end of the 18-month payment period will not mean that any remaining instalments of bereavement payment are lost.

Bereavement payment, bereavement allowance and widowed parent's allowance still apply if a spouse or a civil partner died before 6 April 2017.

9. Taking a Retirement Income

Learning Objective

3.8.1 Be able to evaluate the different ways of taking benefits: reasons for taking or deferring state retirement benefits; considerations when taking income and/or lump sum benefits from a DB scheme; considerations when taking income and/or lump sum benefits from a DC scheme

3.8.2 Be able to analyse the advantages and disadvantages of different types of annuities

3.8.3 Be able to assess the eligibility for an enhanced or impaired annuity

9.1 Deferring the State Pension

The state pension is something that must be claimed; so if a person wants to defer taking it to a later stage, then they simply do not claim it.

Even those already claiming state pension can choose to stop payments and defer for a period of time.

The government offers an incentive to those that choose to defer in this way; however, the incentive is not as generous as it was for those who reached SPA before 6 April 2016. We will look at both scenarios:

Those who reached SPA before 6 April 2016:

- An extra 1% of pension is received for every five weeks of deferral.
- 12 months deferral equated to 10.4% extra pension per year.
- The extra pension could be claimed as a higher weekly payment.
- As a lump sum if deferral was for at least 12 months – this included interest of 2% above the Bank of England base rate.
- If death occurred during the period of deferral it was possible for the spouse or civil partner to inherit the deferred benefits.

Those who reached SPA on, or after, 6 April 2016:

- A state pension increase of 1% of pension for every nine weeks' deferral.
- 12 months deferral equates to just under 5.8%.
- The deferred amount is paid with the normal state pension payment.
- There is no longer the option to take the deferred amount as a lump sum.
- It is not possible for a spouse or civil partner to inherit deferred benefits (but they can claim up to three months' arrears of state pension).

There could be various reasons for someone to defer taking their state pension, including:

- if they are still working
- if they are living off their savings, PCLS, or ISAs, or
- they could be managing their income tax liability (for example, deferring until a point when they have moved from being a higher-rate taxpayer to a basic-rate taxpayer).

If you would like to know more about deferring the state pension, information is available on the gov.uk website[1].

9.1.1 Considerations for Taking Benefits from a DB Scheme

DB schemes all have a normal retirement age (NRA). However, if the member decides to take the pension before this age (the earliest age is 55) it will be at the discretion of the trustees and any pension received will be reduced by an early retirement factor. This means that the pension is reduced by a percentage for each month between the date of the early retirement and the date of normal retirement.

Conversely, if the member decides to retire later, their pension may be increased by a late retirement factor depending on the scheme rules.

Some schemes offer a separate PCLS to the pension income. Most schemes, however, offer the PCLS via commutation of income which means that the pension income is reduced for every £1 of PCLS that is taken. The reduction is based on a pre-determined basis.

Deciding when to start taking benefits from a DB scheme can be a key decision in retirement planning. Given the often large actuarial reductions applied as early retirement factors, individuals might be better using other assets, such as ISAs, money purchase pensions and cash savings to fund their standard of living until the scheme's NRA, when they could take their full pension without suffering a penalty.

9.1.2 Considerations for Taking Benefits from a DC Scheme

When someone decides to access their money purchase pension, they can take benefits either as an income or as a lump sum, or both. As you will recall, there is no guarantee as to what the benefits will be as it will depend on the size of the fund that has been accumulated.

An individual can buy an annuity, take a UFPLS, or enter into FAD.

Both UFPLS and FAD offer a huge amount of flexibility and the option of phasing retirement income can also be used. This is when the member selects a level of income and then sufficient funds are crystallised and placed into drawdown to provide the income required. By using the PCLS, this can also provide an element of tax-free income.

Whatever the income level taken, it is important that consideration is given to the impact the income has on the remaining fund.

In simple terms, if the income taken is more than the growth of the fund, the fund will erode.

1 https://www.gov.uk/deferring-state-pension

Under capped drawdown rules, pension providers were required to provide a 'critical yield' on their illustrations; this showed the investment return required by a drawdown pension to match the income that could be provided by a traditional annuity.

The critical yield took into account the additional costs of drawdown and 'mortality drag'. When someone buys an annuity, they benefit from 'mortality cross subsidy', ie, the rate is calculated on the assumption that a certain number will die early. With capped drawdown there is no such cross-subsidy, so to provide a comparable income, a higher investment return is needed. This is known as mortality drag: the additional annual percentage rate by which the fund growth has to exceed the interest rate used in the annuity. However, under FAD or UFPLS, pension providers are no longer required to provide a critical yield.

This means that developing a strategy for withdrawals is essential. Without taking advice, and having regular reviews, an individual might find that an excess level of withdrawal could lead to the pension fund not lasting for as long as they need it to, or that the level of annuity available in the future is too low because the pension fund has not grown at, or above, the critical yield.

It could well be that some clients may choose not to take any income from their pension as they may prefer to leave it to their beneficiaries on death. Alternatively, some individuals might wish to take high levels of income from their pension to repay debt, fund business ventures or pay for luxuries. This could be part of their financial plan so long as they have sufficient other income to support their expenditure requirements when the pension fund is exhausted.

9.2 Choosing Annuity

Lifetime annuities are provided by life insurance companies; historically, they were the only option available to many individuals. However, annuity sales have reduced considerably in the last 20 years, and even more so since the introduction of pension freedoms in 2015.

Despite the availability of pension flexibilities, however, annuities still remain suitable for those people who wish to secure a regular guaranteed income for the rest of their lives. There is no danger with an annuity that the pension fund will run out as there is with a drawdown pension fund.

For lifetime annuities bought since 6 April 2015, the maximum guaranteed period of ten years has been lifted; there is now no limit to how long a guarantee period can last (although this will be subject to the insurance company's product features).

Different options can be included; these need to be considered carefully to ensure that the correct benefits are included for the individual.

For example, a joint life annuity can be set up so that the income continues after the first death to benefit the surviving spouse; however, anyone can be added to an annuity at the outset, not just a spouse.

The costliest option is the inclusion of an increasing income by a fixed percentage, or linked to an index (eg, inflation). The starting income of an index-linked annuity can be over 30% lower than a level annuity.

The options chosen at the outset by the annuitant have an impact on the level of starting income that an insurance company is prepared to offer in return for a lump sum.

9.2.1 Types of Annuities

As well as traditional annuities, which are gilt-backed, investment annuities are also available.

With-profits annuities allow an individual to buy a regular income, but are also designed so they benefit from the investment growth in the with-profits fund. The returns are structured to give smoothed returns to investors. As with any with-profits fund, the growth is paid as a bonus.

Unit-linked annuities also vary in the income they provide as they will depend on the performance of the fund; with a unit-linked fund, there is no smoothing as with the with profits annuity.

Flexible annuities have been available since 2015 and these are able to decrease by an amount that will be specified in the annuity contract. You should note that payments from a flexible lifetime annuity will trigger the MPAA rules, whereas payments from a conventional annuity will not.

Short-term annuities offer a regular income for a specific term compared to a lifetime annuity which is paid until death.

An individual can use part of their drawdown pension fund to buy a **short-term annuity** contract from an insurance company of their choice. A short-term annuity contract will pay them a guaranteed amount each year. The contract can last for up to five years and it does not have to come to an end when the person reaches the age of 75.

If a short-term annuity is purchased from a flexible drawdown fund there is no upper limit on the amount that can be paid. However, where a short-term annuity is bought using funds from a capped drawdown fund, there is an upper limit on the amount the short-term annuity can pay of 150% of the basis amount, less any income that is being taken from the capped drawdown fund.

In some instances, clients may be eligible for an enhanced and/or an impaired life annuity. Impaired life annuities are available to clients with professionally diagnosed medical conditions which are expected to result in a below-average life expectancy. Enhanced annuities may be on offer to those who do not have a specifically diagnosed medical condition, but who exhibit one or more lifestyle factors which have been proven to pose an increased risk of early death.

Enhanced and impaired annuities may offer enhanced rates of payment. However, as with life or health insurance policies, they are subject to a stringent underwriting process.

Where a life or health protection policy is taken out, the insurer will generally wish to satisfy itself at the point of sale that the insured is in good health. This is because where an applicant has pre-existing medical conditions or significant lifestyle risk factors, it increases the likelihood of a claim on the plan during the term of the policy, which means a higher likelihood that the insurer will have to pay out.

Therefore, such customers will be considered higher risk and the premium payable covered will be increased from the standard cost in order to reflect that risk. As a result, it is important to the insurer that they are diligent in identifying any such risk factors, as they may lose out if this is not done.

Where an annuity is applied for, the situation is reversed. The starting assumption when providing a quote will be that the client is in normal health for someone their age. Where pre-existing medical conditions exist or the applicant has a high-risk lifestyle then this increases the risk of early death and it is likely to be the annuitant who loses out if those factors are not taken into consideration. Therefore, it is up to the applicant to assert and evidence that they are in less than perfect health.

Medical conditions or lifestyle factors which may trigger enhanced annuity rates may include the following:

- diabetes
- heart disease
- cancer
- stroke
- kidney/liver problems
- high blood pressure
- smoking/drinking heavily, and
- obesity/ inactivity.

Applicants for impaired life annuities will need to be prepared to undergo a detailed and invasive underwriting and assessment process. This will involve completing questionnaires regarding their medical history. This would generally cover factors such as height weight, medical history, any medication being taken together with drinking and smoking habits. Applicants with serious health conditions may need to provide a doctor's report and/or undergo a detailed medical examination at the provider's request.

Applications for impaired annuities will still be underwritten. However, these are likely to be less heavily scrutinised and assessed by means of a points-based system produced by a specialist insurance company.

How much of a premium will be paid in respect of particular conditions or lifestyle factors is up to the provider. As an example, being significantly overweight could increase income with some providers by 10–15%, while multiple heart attacks or strokes could boost it by 30%.

Although enhanced and impaired life annuities offer better rates and, therefore, increased income for those who have a predicted shorter life expectancy, if life expectancy is very short someone may prefer not to buy an annuity and, instead, leave their pension to their chosen beneficiaries on their death.

The main features, advantages and disadvantages of the main types of annuities can be summarised as follows:

Type of product	Flat rate annuity	Joint annuity	Escalating annuity	Flexible annuity	Short-term annuity	Enhanced /Impaired annuity
Cost/ annuity rate	Cheapest/ best rate	More expensive	Usually most expensive	Depends on options	Depends on options	Usually better rate
Inflation	At risk	Can be protected	Protected to degree chosen	Can be protected	Can be protected	Can be protected
Availability	Standard	Standard	Standard	Standard	Limited to drawdown funds	Limited to impaired heath
Underwriting	Standard	Standard	Standard	Standard	Not usually applicable	Enhanced
Flexibility	N/A	N/A	N/A	Available	Not usually available	N/A
Money purchase annual allowance	Not triggered	Not triggered	Not triggered	Triggered	Triggered as drawdown payment	Not triggered
Term	Life	Life	Life	Life	Up to 5 years	Life
Death benefits	None unless selected	Income to joint holder	None unless selected	None unless selected	Usually to nominee	None unless selected

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **List the advantages of a defined benefit (DB) scheme.**
   Answer reference: Section 2.3

2. **What is the annual allowance?**
   Answer reference: Section 4.1.4

3. **What is the taxation position of a lump sum death benefit from a money purchase fund where death has occurred before age 75?**
   Answer reference: Section 4.1.7

4. **Why was auto-enrolment legislation introduced in the UK?**
   Answer reference: Section 6.12

5. **State two assumptions set by the Financial Conduct Authority (FCA) for use in a transfer value comparator.**
   Answer reference: Section 7.14

6. **Which is the only government-funded pension scheme?**
   Answer reference: Section 7.15

7. **What is the annual management charge (AMC) on a stakeholder pension taken out this year?**
   Answer reference: Section 7.16.3

8. **Explain what is meant by the term 'life styling'.**
   Answer reference: Section 7.16.3

9. **If someone wishes to go into flexi-access drawdown, at what point is the money purchase annual allowance triggered?**
   Answer reference: Section 7.19.3

10. **Explain the difference between an enhanced annuity and an impaired annuity.**
    Answer reference: Section 9.2.1

Chapter Four

Retirement Solutions

1. **Financial Planning and Advice for Retirement** **237**
2. **Post-Retirement Investment Strategies** **248**

This syllabus area will provide approximately 12 of the 80 examination questions



1. Financial Planning and Advice for Retirement

Learning Objective

4.1.1 Understand the importance of the need to align planning and advice with a client's essential needs and realistic financial aspirations and ensure recommendations are suitable

4.1.2 Be able to analyse retirement aims and objectives taking account of the following factors: availability and prioritisation of savings and investments; limits on tax-relieved contributions and their impact on accumulation methods; attitude and expectations as regards retirement and working in later life; assumptions and impact; conflict with other objectives; timescales and risk, including inflation and longevity risk

4.1.3 Be able to evaluate existing policies and alternative solutions available for pension income and long-term care requirements: alternative sources of capital including non-pension investment assets; equity release products; proceeds from sale of a business or property; inheritance; buy-to-let, individual savings accounts (ISAs), unitised securities, alternative investments; Shariah-compliant solutions

4.1.4 Be able to evaluate the merits, limitations and suitability of investments available to meet stated objectives taking account of: when and how retirement may occur; phased retirement; projected levels of investment risk and return; investment strategy and fund selection criteria; impact of fees and charges; products and wrappers, critical yield and optimal crystallisation dates; other sources of non-pension income

1.1 Retirement Aims, Objectives and Risks

1.1.1 Aims and Objectives

Retirement is a stage of life that is for most people inevitable; however, not enough people understand what is needed to provide themselves with a decent and adequate income in those years. A report published by the Pensions Policy Institute in 2021 estimated that up to five million people approach retirement, one quarter of the population, risked not having the income they needed in retirement. The report also found that over 90% of people of all ages with defined contribution schemes risked falling short of their expected retirement income.

Establishing a client's retirement aims and objectives is the first step in providing retirement planning advice. When considering how spending might alter in retirement, the first reaction of many is that their cost of living will be lower, as they will in most cases have paid off their mortgage and may have fewer social engagements and interests. However, many people reaching retirement find that they have more time to pursue interests and take longer holidays and so they would need the funds to make this achievable.

Retirement objectives will differ between individuals, and it is the role of the financial planner to objectively analyse these aims in order to determine funding requirements and relevant investment strategies. When establishing retirement objectives, some important questions need to be asked, including the following:

- When would the client like to retire?
- Is the client considering a **phased retirement**?
- Are there any capital needs at retirement (for example, the repayment of a mortgage)?
- How much income will they need through the various stages of retirement (some clients see a spike in expenditure in the early years of retirement as a result of increased travel)?

Once the answers to these questions have been established, it is then possible for the financial planner to analyse how realistic the objectives are, and if and how they can be achieved. The feasibility of meeting the income needs for retirement will, to a large extent, depend on:

- the amount of funds that the client has available to dedicate to their retirement pot
- their willingness and ability to take on risk, or
- how close the client is to retirement (ie, their stage of life).

1.1.2 Risks

The client's ability to take on risk is, in theory, positively correlated to their time horizon; this essentially means that the younger they are, the more risks their portfolio should be able to tolerate. The client's willingness and capacity to assume risk is based on their financial situation as discussed in chapter 1.

It is worth noting that risks in terms of a client's retirement planning are not confined to investment risk and volatility. There are a whole host of other factors that may impact the client's ability to maintain their desired standard of living in retirement.

The key factors are inflation risk and longevity risk. Inflation, in simple terms, is the tendency for consumer goods to rise in price over the long term. Inflation is usually measured by the retail price index (RPI) or the consumer price index (CPI). Since 2011, the latter has been used as the 'official' measure of inflation in the UK.

The current government target is for inflation of 2% pa. Where inflation moves away from the target by more than one basis point in either direction, the Governor of the Bank of England (BoE) is required to write to the Chancellor of the Exchequer outlining the reasons and the policy actions taken in response.

The requirement to write the above letter was triggered in September 2021 when rates hit 3.1%. Since then, inflation has escalated significantly, peaking at 11.1% in October 2022. In response, the Bank introduced a series of aggressive interest rates rises aimed at containing the problem, which caused inflation as measured by CPI to fall to 3.4% in February 2024.

In 2024, it briefly fell back to the 2% target before rising again as previous falls in energy prices fell out of the equation. However, keeping the figures at this level has proved problematic and the Office for Budget Responsibility forecasted an average of 2.6% for 2025 at the time of writing.

When planning and cashflow modelling for a client's retirement, their planner will usually make an assumption in terms of inflation over the long term. Where inflation is significantly higher or lower than this assumption, there is the potential for a negative or positive impact on the client's real purchasing power in retirement. The longer the term of the assumption, the more pronounced the impact.

Average life expectancy in the UK based on historic data is currently 81 years (this is an estimate based on the mean average and is slightly higher for women, who are expected to live an average of 83 years to 79 for men). However, the most common age of death in the UK (the modal average) in 2020, the most recent figures currently available, was 88 for women and 86 for men. But a 65-year-old male in the UK today has a 25% chance of reaching 92, a 10% chance of reaching 96 and a 2.9% chance of reaching 100. A 65-year-old woman has a 25% chance of reaching 94, a 10% chance of reaching 98 and a 5.3% chance of reaching 100.

Where they are reliant on an invested portfolio to meet expenditure, unexpected longevity increases the possibility of a client running out of money during their retirement. This risk is particularly pronounced where expenditure is higher than expected and/or investment returns are poor during the early stages of retirement. The latter will be considered in more detail later in the text.

Based on the above, the financial planner should begin by assessing the client on the basis of their stage of life. Note that each individual's situation will be different depending on, for example, their starting point, life experiences, ambitions and abilities. The following should, therefore, be used as an initial framework for assessing the individual client.

1.1.3 Stage of Life Assessment

For the purposes of retirement planning, the financial planner can assume that each client passes through the following three stages:

1. **Foundation**
   Typically, the foundation stage applies when the individual is in their 20s. At this stage, the individual is attempting to establish a foundation for accumulating wealth. They may either be setting up their own business or getting a foot onto the career ladder; as such, this stage is characterised by a low level of assets and high financial uncertainty. Because of a long-time horizon, risk tolerance should be relatively high.

   The financial plan should cover managing debts, such as credit cards, student loans and personal loans, creating a budget to track and control spending, enrolling the client in a company pension plan and setting aside funds for savings and investment (eg, opening an individual savings account (ISA) or Lifetime ISA (LISA) as discussed below). Note that a client may wish to prioritise current spending and meet immediate needs instead of paying off debt and setting aside funds for investment.
2. **Accumulation**
   Accumulation can begin in one's 30s and continue until retirement; this stage can, therefore, be split into early accumulation and late accumulation.

   With early accumulation the individual experiences an increase in earnings as the foundations laid in their 20s begin to pay off. This stage is characterised by high expenditure on a combination of assets and paying family related expenses, such as child care and education. Risk tolerance is still above average because of the long/medium time horizon.

   The financial plan should, as a minimum, cover short-term debt management, purchasing a property, increasing pension savings and investments (maximising ISA allowances and/or tilting the portfolio towards equities) and possibly contributing to a self-invested personal pension (SIPP), discussed in chapter 3, section 7.17. Note that although the long/medium time horizon allows for high risk tolerance, clients may not wish to take on risky investments because of current financial and/or family commitments.

   Late accumulation is characterised by lower expenditure as mortgages may come to an end and children begin to leave home. It is, typically, at the late accumulation stage that most individuals find that they have surplus funds for investing in a retirement portfolio. Risk tolerance, however, begins to decline.

   The financial plan for late accumulation clients should cover boosting retirement savings and investments through carry forward of unused annual allowances in the previous three years, and utilising other income, such as bonuses received. A realistic calculation of the required retirement income should be carried out and an analysis of whether the portfolio is on track to achieve the target return should be performed. The portfolio's risk exposure should begin to move from high to medium/low risk investments. Note that some clients may not actually have surplus funds for investing as they may be paying for the care of elderly parents or assisting children who are considering purchasing their first property.
3. **Maintenance**
   The maintenance stage begins at retirement. Financial security and a sustainable source of income to maintain living standards are paramount objectives. Risk tolerance is at its lowest in this stage. In terms of financial planning, the objective of growing the pension portfolio's assets should gradually move to maintaining the real value of the assets. A sudden shift from risky assets, such as equities,

to less risky assets, such as government bonds, should be avoided. A gradual tilt is recommended to ensure that the portfolio retains some exposure to risk – the aim is to avoid depletion of the pension portfolio's assets if the client lives beyond the predicted time frame.

Note that each client's situation is different. You may encounter a client in their 20s who has had a large inheritance is, therefore, in a better position to start investing and taking on risk than another client in their 40s who was made redundant, does not have a large amount of savings, and is having to retrain to re-enter the job market. There will also be clients who do not have family commitments or those who start a family later in life. The advice and recommendations made at each stage should be based on the client's specific circumstances and should not be generic. All portfolios should be regularly reviewed to ensure that objectives are still relevant and that the portfolio is on course towards achieving the stated objectives. Reviews are discussed further in chapter 5, section 3.

1.2 Fund Selection

Pension funds normally comprise a mixture of equities, fixed-interest securities, property investments and funds, and derivatives. The investment options change with the circumstances, risk tolerance and aims of the individual. The following are three possible risk profiles of funds:

- **High risk** – the fund will be invested mainly in equities to provide capital growth over the long term.
- **Medium risk** – the fund aims to provide capital growth over the long term. The mix of investments gives the possibility of high returns from equities, but with the safety of spreading the risk over a wide range of assets, including bonds, property and cash.
- **Low/medium risk** – the fund aims to provide capital growth over the long term with a low level of risk. The mix of investments aims to achieve a higher level of return than cash alone by investing in fixed-interest securities.

When selecting funds, it is important to consider the associated risks, how the fund is correlated with other funds or investments that the client holds, and whether the overall risk is in line with the client's attitude to risk and capacity for loss.

The higher the charges applied for investment management and financial planning advice, the lower the net return to the client. Ultimately, it is net return that is important; therefore, a single focus on low charges is not going to increase the net return of a portfolio if the investments are poorly chosen.

Example

A fund that would be suitable when the investor has less than five years to retirement is one that aims to track the performance of the FTSE Actuaries UK Gilt Index for gilts with an outstanding term of over 15 years. The fund invests in UK Government fixed-interest stocks whose performance matches the costs of buying a pension income (annuity).

An alternative approach might be a fund that aims to provide a safe return, in line with bank and building society interest rates, by investing in cash investments with major banks and UK companies. The fund has very little risk attached to it and aims to protect values from falling (but, of course, this is not guaranteed).

1.3 Alternative Solutions

Some individuals choose not to save for retirement via a traditional retirement plan, instead opting for other methods of funding, such as an additional property, business assets or investments. The key issue in terms of retirement planning is ensuring that the client understands the implications of using alternative solutions to fund retirement, as these do not offer the same tax incentives as recognised retirement plans and can in some instances, pose a high degree of risk. The following solutions may be used as an alternative to, or to complement, traditional pension products.

1.3.1 Equity Release Schemes

Equity release schemes can provide funds in the form of a tax-free cash sum from an individual's home while allowing them to continue living there as long as it is their main residence.

There are two main types: lifetime mortgages and home reversion plans. Typically, flexibility to transfer the plan to another property without penalty is one of their advantages, together with a built-in guarantee that the property does not fall into negative equity. These would normally be contractual rights. This means that a proportion of the equity of the property can still be passed to beneficiaries upon the planholder's death.

1.3.2 Proceeds from Sale of a Business

When a client sells a business, there will be tax implications in the form of capital gains tax (CGT). The amount of CGT charged depends on whether the client has sold the business itself for cash or has only sold their shares in the business. Business asset disposal relief (BADR) is available; this charges CGT at a reduced rate of 10% providing the client is on the first £1 million of qualifying gains.

The relief is available where the client is disposing wholly or partly of a business as a sole trader or a partner. It is also available where they are disposing of shares in a trading company, provided that the total holding represents at least 5% of total shares and voting rights.

For tax relief to apply, the business or shares must have been owned for at least two years. If the business is a limited company, the individual must be an employee and the business must be a trading company. When it comes to relying on the proceeds of the sale of a business to fund retirement, there are various other issues to consider, such as:

- the business may not be worth as much as the owner thinks, and so there could be a shortfall in funds available at retirement, or
- the owner may not be able to find a buyer at the time they wish to retire, which could mean having to delay retirement.

1.3.3 Inheritance

The proceeds of an inheritance could be used to fund retirement. If the client has already received the inheritance, then the financial planner can easily incorporate the assets into the portfolio. In cases where the inheritance has not yet been bequeathed, it is nearly impossible to plan because of the uncertainties surrounding the timing and the ultimate value of the inheritance. For example, a client may be due to inherit from a parent, but the parent's long-term care costs or equity release activities

may have considerably depleted the assets that the client would have expected to receive originally. In addition, the assets may not be liquid so they may be difficult to value and dispose of and, depending on whether the deceased made any provision or took any action to mitigate inheritance tax (IHT) liability, the inheritance could be subject to IHT.

1.3.4 Individual Savings Accounts (ISAs)

An ISA is not an investment but a tax wrapper and can be used as a means of saving for future retirement.

There are now four types of ISA:

- Cash ISA (which includes the Junior ISA and the Help to Buy ISA).
- Stocks and shares ISA (which includes a Junior version).
- Innovative finance ISA (peer-to-peer loans).
- Lifetime ISA (LISA).

Overall, the contributions to ISAs are limited to £20,000 (£4,000 of which can be saved into a LISA) for the tax year 2025–26 across all types of ISA, except the JISA which is limited to £9,000.

Although there is no tax relief on the initial investment, as there is with a pension, the growth is tax free and income can be drawn tax free. Note that with a pension, only 25% of the fund can be taken as a tax-free amount with the rest potentially taxable.

To open an ISA, an individual must be aged 18 or over (except for a cash ISA which can be opened at 16), and under 40 to open a Lifetime ISA.

The flexibility of ISAs has also increased with some providers offering flexible-access ISAs. These allow funds within an ISA to be withdrawn and re-deposited within the same tax year, without the individual's annual allowance being reduced. For example, if a person invests £15,000, and then withdraws £4,000 before the end of the tax year, they will have the ability to deposit £9,000 (being the remaining allowance of £5,000 plus the withdrawal of £4,000).

It is also now possible to inherit the value of an ISA from a deceased spouse or civil partner – this is known as an additional permitted subscription, and the value is taken as the value of the ISA at the date of death.

1.3.5 Lifetime ISAs (LISAs)

The newest type of ISA is the LISA; this was designed to help young people buy their first home or save for their retirement.

A LISA can hold cash or stocks and shares, or a combination of both. Parents and grandparents can pay into the LISA as well as the account holder.

With a LISA, any contribution made by the individual will be matched with a 25% top-up from the government. With the maximum allowance for 2025–26 being £4,000, this means that the maximum contribution by the government is £1,000. The bonus is given on contributions made until the investor is 50, and the plan is designed to provide a retirement fund or to be used to buy a property.

If the cash is withdrawn before the age of 60, other than to use as a deposit for a first home, the bonus plus any interest and growth on that bonus is lost and usually a withdrawal charge of 25% of the amount withdrawn is imposed. This penalty took effect from April 2018. In March 2020, in response to the Covid-19 pandemic, the government temporarily reduced the withdrawal charge to 20%. The full rate was reinstated from the beginning of the 2021–22 tax year.

The withdrawal charge will not apply in the cases mentioned above, or if the individual is diagnosed as having less than 12 months to live.

To qualify for the home purchase, a LISA must be open for at least 12 months and the house being bought must be worth less than £450,000 with the aid of a mortgage. The money must also be paid directly to the solicitor or conveyancer.

Help to Buy ISAs were available until 30 November 2019, and payments can continue into them until 2029. However, if the individual desires, they can transfer funds from a Help to Buy ISA to the new LISA.

Ultimately, whether someone chooses an ISA or a pension to fund for their retirement is down to personal preference and circumstances. The following table summarises the key differences between the two:

	Lifetime ISA	Pension
Eligibility	Those aged 18–39 can open a LISA and can pay in until their 50th birthday	Those aged 16 and over, although some providers will stipulate age 18 and over
Contributions	£4,000 per tax year	Annual allowance of £60,000 and use of carry forward. Tax relievable contributions subject to lifetime allowance
Government assistance	25% bonus	Marginal rate of income tax relief
Employer contribution	Not available	Yes, through auto-enrolment, group personal pension, defined contribution
Withdrawals	Tax free	25% tax free, with the remainder potentially subject to income tax
Access	At age 60, or earlier if being used for a home purchase	At the age of 55, unless in serious ill health. Shortly to rise to age 57.
Other implications	Will form part of the estate for IHT purposes	Do not currently form part of the estate for IHT purposes. IHT to be applied from April 2027.

1.3.6 Buy-to-Let Properties

A buy-to-let property can provide a source of capital growth if property prices rise as well as income, and it can be seen as a good way of diversifying an individual's overall risk exposure. However, one of the key issues in funding retirement via buy-to-let investments is the lack of liquidity, ie, not being able to sell a property quickly enough to release capital when needed. Also, the amount of stamp duty land tax (SDLT) that is payable on the purchase of a second or additional residential property is relatively high – the amount payable is the normal SDLT rate based on the value of the property, plus an additional 5% of the property value where this exceeds £40,000. Additional issues could arise on the death of the investor in terms of IHT liabilities. Management of the property is another issue that should be considered.

1.3.7 Unitised Securities

Unitised securities are commonly used within the underlying investment vehicles for both retirement planning and long-term care policies. They are useful in diversifying risk, particularly if an individual's policy is relatively small. One of the drawbacks of unitised securities is the lack of control the investor has. This is ultimately an issue of accurate risk profiling – a wealthy investor with a suitably large portfolio could hold direct investments and still have a well-diversified portfolio within a pension wrapper. Equally, a wealthy client may be able to afford to fund bespoke long-term care in their own home.

1.3.8 National Savings & Investments (NS&I) Products

NS&I is an executive agency of the Chancellor of the Exchequer and is accountable to the Treasury. It provides deposit and savings products to the investing public and, in doing so, raises funds on behalf of the UK Government; an investor holding an NS&I product is, in essence, lending to the Government. NS&I offers a wide range of products, from easy-access savings accounts to longer-term investments and premium bonds. As the products are underwritten by the Government, they are regarded as being effectively free from the risk of default. No NS&I product is subject to CGT, but some are subject to income tax. The range of products changes as some expire and new ones are introduced.

1.3.9 Alternative Investments

Traditional asset classes include equity and fixed-income securities such as shares and bonds. Alternative investments include (but are not limited to) hedge funds, derivatives, antiques and fine wine. While there is no reason to suggest that these types of investment should not be used to fund retirement, the issues of liquidity – and, in the case of derivatives and hedge funds, additional levels of risk, uncertainty, cost and complexity – make these investments unsuitable as a stand-alone strategy. Care should also be taken when advising retail clients as certain alternative investments, such as hedge funds will not be applicable.

1.3.10 Shariah Pensions and Investments

Shariah-compliant investments are based on the principles of Islamic finance which state that financial transactions should be based on fairness, profit and loss sharing and real transactions. The concept of interest (*riba*), where money earns money, is prohibited. Investing in businesses that provide goods or services considered *haram* (ie, against Islamic principles) is also forbidden, eg, those related to alcohol, gambling and pork products to name a few. According to S&P Global Ratings, the industry's assets were valued at £1.85 trillion globally at the end of 2019.

In terms of Shariah-compliant pension funds, the NEST Shariah fund was launched in 2011 and provides an option for those wishing to save for retirement in a manner that conforms to the principles of Islamic finance. The fund only invests in shares that are considered to be Shariah-compliant and may, therefore, be exposed to a greater level of risk than other pension funds because of limits on diversification. The fund's investment strategy is aligned to the HSBC Islamic Global Equity Index which is designed to measure the performance of the world's largest Shariah-compliant equities.

1.3.11 Collective Investment Schemes (CISs)

Collective investments such as unit trusts, open-ended investment companies (OEICs) and investment trusts, are pooled investment vehicles or funds which can be accessed by individuals as a means of saving and investing for retirement.

Collectives are useful for diversifying risk, particularly if an individual's investment is relatively small. One of the drawbacks, however, is that the individual will no longer have control of investment decisions as this will now be the responsibility of the fund manager. Although this means that the investor has no control over the selection of underlying stocks, if the risk profiling has been carried out properly, the individual will be likely to have a fund or funds that produce the required levels of returns.

Investment into a collective investment does not receive tax relief, as is the case with pension contributions. The tax treatment of income and capital gains is summarised below:

- Dividend income is paid gross but is taxable.
- Interest income is paid gross but is taxable.
- No tax on gains within the fund.
- The investor is potentially liable to CGT upon disposal.

There are no restrictions on when capital can be withdrawn from collective investments and no restriction either on annual investment limits. These funds are regulated by the Financial Conduct Authority (FCA) which means that retail investment clients can invest.

2. Post-Retirement Investment Strategies

Learning Objective

4.2.1 Understand the reasons and ways to access pension funds

4.2.2 Be able to evaluate phased retirement options, benefits and risks

4.2.3 Be able to analyse the options and factors to consider with regard to developing a post-retirement investment strategy for: financial provision for care in later life; timing of decisions and implementation; provision for dependants; sequencing risk; sustainability of income in retirement

2.1 Retirement Options

A pension is intended as a savings vehicle to fund a client's retirement. There are, therefore, restrictions on access to pension funds. A client will not usually be permitted to access their fund until the age of 55, other than in the following circumstances:

- They are forced to retire early due to ill health.
- They were a member of a scheme at A-day (6 April 2006), which had an unqualified contractual right to retire at a younger age.
- At A-day, they were in one of a range of special occupations, for example, professional sportspeople, which had a normal retirement age below 50.

It should be noted that the normal minimum pension age was originally set at age 50 as of A-day and increased to 55 in 2010. It is scheduled to rise to 57 when the state pension age (SPA) increases to 67 (current scheduled between 2026 and 2028). It is intended that this will remain ten years below the SPA and, therefore, any future increases in the SPA will result in a further rise.

At retirement, individuals now have a range of options available to them thanks to the pension freedom reforms.

For individuals with a defined contribution (DC) scheme, the options would usually include the following:

- annuity purchase
- uncrystallised funds pension lump sum (UFPLS)
- flexi-access drawdown (FAD)
- (where offered) purchase of a scheme pension paid directly from the assets of the scheme.

Generally, 25% of the value of the fund can be paid as a tax-free pension commencement lump sum (PCLS), with the balance used to provide a taxable income. As a general rule, annuity purchase and/or scheme pension would tend to appeal more to the risk-averse scheme member. These options offer the guarantee of a secured income for life, with the option to also inflation proof the income and select death benefit options.

A drawdown plan would be more appropriate for those with a higher risk appetite and the ability to bear losses. For those selecting this option, their fund simply remains invested to be drawn from on a regular basis like a bank account when the individual requires income. This can be on a monthly or annual basis, or any other such basis that the member may deem appropriate.

For defined benefit scheme members, the default option is a scheme pension and the view of the FCA is that the majority of members are best advised to take their scheme benefits. However, some may elect to transfer out of their schemes for the purpose of taking advantages of the greater flexibility offered by a drawdown fund in terms of timing income and death benefits. For those in poor health, an enhanced annuity may also be available, providing a better rate of income than the scheme pension.

The freedoms had a significant impact in the form of reduced annuity sales and on the rising popularity of drawdown as a means of providing a retirement income. However, as noted in chapter 3, this is a trend which has started to reverse itself lately as better rates increase the attractiveness of annuity purchase.

It remains to be seen whether this trend will continue. The intention of the Bank of England is to gradually cut rates, although it is unlikely that they will again fall as low as they did in the aftermath of the Covid-19 pandemic. However, gradual cuts may serve to reduce the attractiveness of annuities as an option. Conversely, the announcement of IHT being applied to pensions with effect from April 2027 may serve to make a secure income for life appear a more appropriate option.

Not all schemes offer the full range of pension flexibilities. Older pension contracts are more likely to only offer annuity as a means of providing a retirement income, therefore, if an individual wants to flexibly access their pension, they would need to transfer it to a scheme that does offer flexible access.

2.2 Pension Consolidation

On many occasions, where a client is approaching retirement, their adviser may recommend that they undertake a pension consolidation exercise.

These types of exercise are typically undertaken by members who wish to access their retirement benefits flexibly and are likely to work with a professional adviser. However, those who wish to annuitize may also look at consolidating their holdings prior to doing so in order to have one simple payment with one provider.

The days when most people had a job for life are long gone. Many workers will typically have several employers during their careers and in some cases periods of self-employment or running their own limited company. A number may have had multiple careers.

With the introduction of auto-enrolment in 2012, all eligible jobholders are automatically enrolled into their employer's pension scheme unless they opt out of being enrolled. Those that opt out are auto-enrolled back every three years unless they actively opt out again. This has had a significant increase in the number of people actively accruing pension benefits. However, it has also meant that many people are approaching retirement with numerous occupational and/or personal pension pots from varying employments and of varying sizes.

There are a lot of benefits to pension consolidation. Often, some older pensions from the 1980s and 1990s are very restrictive compared to their modern equivalents, particularly trust-based occupational ones. Many of them may not offer flexi-access drawdown as a vesting option. They may offer restrictive death benefits such as lump sum return of fund only. Many also require paperwork to be completed to make changes to the plan.

Some may not permit third party advisers to give instructions on the plan, although they will disclose details on receipt of a letter of authority. Many schemes do not facilitate adviser charging. This is not ideal for the client as legislation permits fees for advice relating to the pension to be deducted from the pension before payment of tax. If this cannot be facilitated then the member may have to pay the fees directly out of their own pocket, which is not as tax efficient.

By contrast, many modern contract-based schemes offer a full range of vesting and death benefits options, beneficiary drawdown, adviser charging and easy to use online services to make changes to the plans. Consolidating into one of these plans can therefore offer a streamlined approach to retirement, with all of the client's assets on one easy to use platform. This can also be combined with other assets such as ISAs, general investment accounts or investment bonds.

The trade-off for this is that a lot of older and larger workplace pension schemes can benefit from very low charging structures as economies of scale apply. These are not always available on newer pension which may have more expensive overall fund charges.

Many wealth management firms choose to operate a centralized investment proposition. This typically consists of a set of model portfolios which are considered appropriate for clients of varying risk levels. For the wealthier, higher-end, more sophisticated type of investor, some may offer bespoke managed portfolios.

The Financial Services Authority, predecessor to the FCA, published a report as far back as December 2008 in which it highlighted the findings of a thematic review it had carried out into pension switching advice. Results were varied, with approximately a quarter of firms providing no unsuitable advice. However, a further quarter were deemed to be providing unsuitable advice in 25% or more of cases reviewed. Overall, the regulator deemed 16% of the advice files it reviewed to be unsuitable.

Of the files which were found to be unsuitable, the main drivers for that determination were as follows:

- the switch involved additional product costs which were not sufficiently justified (79% of unsuitable cases);
- the switch involved loss of benefits from the ceding scheme without good reason (14% of unsuitable cases)
- the fund(s) recommended were not suitable for the customer's attitude to risk and personal circumstances (40% of unsuitable cases);
- the adviser failed to explain the need for, or put in place, ongoing reviews when these are necessary (26% of unsuitable cases);

A further review carried out in 2012 outlined concerns that firms were not always convincingly demonstrating why an increase in costs was justified in the context of the client's overall circumstances and that clients were, on occasion, being shoehorned into the firm's centralized investment proposition without adequate consideration of their needs.

The FSA remarked as follows:

'We recognise there can be benefits to offering a CIP for both clients and firms. Clients can benefit from more structured and better researched investments and firms can benefit from efficiencies in the management of risks associated with investment selection.

However, we have concerns that, in certain circumstances, a CIP may be unsuitable for a retail investor. For example:

- 'Shoe-horning' – firms might recommend a 'one size fits all' solution which is not suitable for the individual needs and objectives of a client;
- Churning – firms might advise clients to switch their existing investments into a CIP without adequate consideration of whether the switch is both suitable and in the client's best interest; and
- Additional costs – the use of a CIP might result in higher (and potentially less transparent) charges than the client's existing investments and with few additional, actual benefits'.

The firm therefore needs to consider two options:

- Is there a good reason to switch the pension to the new provider when considering the functionality offered by both respective schemes?
- What is the most appropriate investment strategy for the client when considering costs?

A number of older plans may also have a range of features or benefits which may be lost in the event of switching to a new plan. These therefore need to be considered carefully and in context.

Guaranteed annuity rates

A number of pension schemes available in the 1990s and earlier offered a guaranteed annuity rate. These can be very attractive with some rates around 10%, significantly higher than anything available on the open market today. Where a scheme has such a rate, it may make a lot of sense to take it, particularly for more risk-averse clients.

Conversely, many of these rates do have restrictions. They are sometimes only available at a set retirement age or may significantly reduce if taken earlier. Some may only allow single life annuities. Weighing up how the options fit into the client's life plans is a key consideration.

Guaranteed annuity rates are becoming less and less common occurrences. A significant increase in life expectancy meant that most providers had stopped offering them by the turn of the century.

Protected tax-free cash

As of A-day (6 April 2006) all of the previous pension legislative regimes were consolidated into one, with a uniform tax-free cash entitlement set at 25%.

Some schemes which were in effect prior to that date benefitted from a tax-free cash entitlement in excess of that amount. Where this was the case, the member was permitted to retain the entitlement to the higher amount. This entitlement was automatically registered with HMRC by the scheme administrator, with no involvement required from the member. The protected entitlement was based

only on the fund value at A-day, with any further contributions and/or growth after that date subject to the standard 25% tax-free cash entitlement.

Where protected tax-free cash is held then this can be a very valuable benefit and as it is scheme specific it would be lost on transfer out of the scheme. Consideration should therefore be given to retaining the product, at least until the tax-free cash has been taken.

Protected early retirement ages

In addition to the 25% tax-free cash entitlement, A-day also standardized the normal minimum retirement age at 50.

Some schemes contained within their rules a right for the member to take benefits from an earlier age. Where that right existed as of 10 December 2003 (the date the announcement was made) and was unqualified (i.e. the member did not need to seek the permission of the trustees) then the member was permitted to retain the earlier retirement age.

The minimum pension age was increased to 55 as of April 2010 and a similar provision was put in place to protect members with an unqualified right to retire earlier. The same will apply when the age increases to 57 in 2028.

Whilst retirement prior to the age of 55 is very unusual nowadays, it is still important to look out for such features and if they do apply then how this may fit into the context of the client's retirement plan.

Exit charges or penalties

Some pensions charge early exit penalties if the member transfers their benefits away within a certain period of joining or before the normal retirement date.

In some circumstances, the charge may be relatively low and the member may be happy to accept it. However, consideration should be given to whether it may be possible to avoid such a charge by leaving the pension in place for a period of time.

Bonuses or guarantees

Some pensions offer guaranteed growth rates, particularly in the with-profits market. These are typically pensions provided by insurance companies. Whilst the rates may often not be particularly attractive, they may appeal to the more risk-averse client.

There may also be bonuses attached to the policy which can be removed at any time or which may be taken away on switching. Again, it is important to ascertain whether these apply and if so their relevance to the client.

Guaranteed Minimum Pension (GMP)

Prior to 1997, where a member was contracted out of the state earnings related pension scheme (SERPS) by way of a defined benefit occupational scheme, that scheme received the national insurance contributions that would have been paid towards SERPS. As a trade-off, the scheme had to undertake to provide a guaranteed minimum pension which was at least in line with what the SERPS entitlement would have been.

Where a defined benefit scheme was being wound up at the time, the benefits would be bought out by way of a deferred annuity known as a section 32 contract (after section 32 of the Finance Act 1981). These are no longer available as new products, however, advisers may still run across existing ones.

Where the member had a GMP entitlement, the section 32 provider bought out the liability. This means that it had to undertake to pay an annuity income at least equivalent to the accrued GMP from GMP age, which was 65 for men and 60 for women. If the fund value was not sufficient to purchase the income then the provider was obliged to make up the difference.

Transfers out of a section 32 plan are not permitted if the fund value is actuarially deemed insufficient to purchase an income equivalent to the accrued GMP from the relevant age. Therefore, it is important to find out if this is the case. Switches out of a section 32 plan which contains GMP are also deemed transfers of safeguarded benefits and therefore need to be subject to the relevant advice process.

The FCA has also commented that it expects consideration to be given to whether consolidation into one of the existing workplace pensions would be an appropriate alternative to a personal pension. Its rules already require advisers recommending pension contributions to outline why a personal pension is more suitable than any facility to make additional contributions to a workplace pension or to contribute to a stakeholder pension.

2.3 Investment Pathways

In 2021, the FCA recognized that there was becoming a tendency towards scheme members taking the tax-free cash from their pension without receiving financial advice and placing the balance into flexi-access drawdown. The FCA was concerned that people were not acting on an informed basis. Particularly that many seemed to be opting to hoard the proceeds in cash and potentially losing out on investment returns.

In order to mitigate this situation, the FCA required drawdown providers operating on a non-advised basis to offer members access to four investment pathways. These are straightforward, simple investment approaches designed to meet the needs of individuals in a number of simple sets of circumstances. The four pathways were as follows:

- Option 1: I have no plans to touch my money in the next 5 years
- Option 2: I plan to use my money to set up a guaranteed income (annuity) within the next 5 years
- Option 3: I plan to start taking my money as a long-term income within the next 5 years
- Option 4: I plan to take out all my money within the next 5 years

The regulator also introduced a requirement for any member who opted to invest in cash to make an active confirmation that they wished to do so and for such members to receive initial and ongoing 'cash warnings' about the risks of doing so. Ongoing warnings can be ceased if the provider becomes aware that the client has started to take professional financial advice.

Investment pathways are generally most appropriate for those members with very straightforward needs.

2.4 Decumulation and Sequencing Risk

Earlier we covered the range of retirement income options. In return for the flexibilities offered, an individual is often taking on risk. For example, an annuity provides a guaranteed income for life, whereas a flexi-access drawdown scheme could provide the same income, but the fund could run out during the client's lifetime if the underlying investments in the scheme do not grow at the required rate, or if inflation and/or longevity are higher than expected. As discussed in section 1.4 of this chapter, the financial planner must follow the FCA's rules when advising on transfers.

During the decumulation phase, another key consideration comes into play, which is sequencing risk, a similar concept to pound-cost averaging. In simple terms, this means that, where withdrawals are being taken from the portfolio, the impact of a poor sequence of returns in the early years will be more pronounced.

Let us consider a client with a portfolio of £1 million and returns over the next five years of –5%, 0%, 5%, 10% and 15%. Try this on a calculator and you will find that it makes no difference if that series of returns is reversed. However, if we factor in an annual withdrawal of £50,000, then the difference becomes quite pronounced, as illustrated by the following comparison:

Year	Initial portfolio value	Returns	End portfolio value	Withdrawal	Final portfolio value
1	£1,000,000	–5%	£950,000	£50,000	£900,000
2	£900,000	0%	£900,000	£50,000	£850,000
3	£850,000	5%	£892,500	£50,000	£842,500
4	£842,500	10%	£926,750	£50,000	£876,750
5	£876,750	15%	£1,008,262.50	£50,000	£958,262.50

Year	Initial portfolio value	Returns	End portfolio value	Withdrawal	Final portfolio value
1	£1,000,000	15%	£1,150,000	£50,000	£1,100,000
2	£1,100,000	10%	£1,210,000	£50,000	£1,160,000
3	£1,160,000	5%	£1,218,000	£50,000	£1,168,000
4	£1,168,000	0%	£1,168,000	£50,000	£1,118,000
5	£1,118,000	–5%	£1,062,100	£50,000	£1,012,100

The combination of return and withdrawal rates can have a serious impact one way or the other on the sustainability of a client's retirement lifestyle. It is the responsibility of a financial planner to monitor the client's expenditure in light of the performance of their portfolio. The adviser needs to identify and act where there are concerns that the client may be in danger of running out of money in the short or long-term.

At minimum, cashflow analysis should be undertaken at each annual review. This should take into account the client's recent spending patterns from their investment pot, together with likely future needs, any known lump sum requirements and any other secured pensions which may be in payment or coming into payment. Cashflow modelling should take into account the client's life expectancy and plan for a worst-case scenario via a range of stress tests. The client should be able to see both the likelihood and the potential impact of depletion of their portfolio.

The FCA has previously set out that it considers that there are three categories of retirement expenditure as shown below:

- **Essential expenditure** – covers basic and necessary costs of living such as mortgage/rent where applicable, council tax, utility bills, goods and clothing.
- **Lifestyle expenditure** – covers non-essential expenditure which is part of normal standard of living, such as meals out, trips to concerts or sporting events or basic holidays.
- **Discretionary expenditure** – covers items such as home improvements, luxury holidays, expensive clothing or brand new cars.

The view of the regulator is that advisers should aim to ensure that expenditure, falling into either of the first two categories, can be met, therefore, a client's standard of living in retirement is not significantly reduced.

A pension fund is ultimately designed for providing a retirement income and some degree of depletion of the pot for that purpose may not be an issue. However, where there are serious concerns that they will have to moderate their lifestyle or, in worst case scenario, run out of money altogether, it is the duty of the adviser to bring this to the client's attention.

Alternatively, if a client is in danger of being too conservative and missing out on living their retired life to the full even where they can afford to do so, the adviser should also advise them accordingly. Modern day financial planning is as much about ensuring that the client uses their resources to live the lifestyle that they desire and can afford as it is about pure numerical analysis.

There has been a degree of academic study over recent years into the concept of sustainable withdrawal rates. This was a concept first examined by the US-based financial planner Bill Bengen, who examined masses of historical data and concluded that 4% was the golden rule as a rate of withdrawal which a client could afford to make.

Sustainability has also been at the centre of a lot of the Financial Conduct Authority's recent thematic work. In 2019/20 concerns were raised about data which showed that approximately 42% of drawdown clients were withdrawing rates of over 8% per annum from their portfolio. The rate of withdrawal was generally greater with smaller pots. This led to concerns that people were exhausting their pots too freely and putting their retirement security at risk.

In order to better understand the data, the FCA launched its thematic review of retirement income advice. As part of this, a detailed questionnaire was sent to a number of firms seeking further data about their advice processes when it came to giving advice on retirement provision and further numerical data.

Critics of the 4% approach have stated that it is very arbitrary and does not consider the secured pension income the client may have available to them, other assets, nor their stage of life. Going forward, with pensions due to be brought into the estate, it is likely that members who might previously have exhausted other assets before touching their pensions are now likely to do things the other way round, which will only serve to make the data even harder to interpret.

There are a number of potential strategies that advisers can use to mitigate the impact of sequencing risk:

- Cash buffers all advisers will recommend that a client leave themselves an emergency fund in cash to cope with any unforeseen eventualities. Whilst typically around 6 months would be considered normal, for clients in the decumulation stage then advisers may recommend 2-3 years in cash and/or short-term fixed rate bonds.
- Horizon planning approach this typically involves segregating the portfolio into a number of separate pots with the risk level aligned to the timescale for use. As part of cashflow modelling, the adviser will ascertain the client's likely level of drawing on the portfolio from year to year. This can also be known as the buckets approach or liability matching.
  Funds earmarked for short-term use, typically within 1-5 years, will be invested in very low risk assets. Conversely, funds earmarked for a very long-term horizon can afford to take a much more high-risk approach. This is, of course, subject to appropriate assessment of the client's own tolerance for risk – many clients find themselves becoming more risk averse when they reach the decumulation stage.
- Dynamic spending strategies may be implemented. In simple terms, this means that the client simply lives according to their means. In years where the portfolio has lost value or growth has been sluggish, the client may take less withdrawals from their portfolio than in years where growth has been strong, or even cease them entirely if it is affordable to do so.
  Another variant on this theme is a natural income strategy, where clients simply take the income that their portfolio has produced and do not touch the capital. This may involve a focus on income-producing funds as opposed to growth ones. Inclusion of fixed-income assets such as short-term annuities may also play a part in this.

- Taking a blended approach. The choice between annuity and drawdown as options is not necessarily a binary one. Many advisers can an do recommend a mix of both. The theory is that by increasing a client's bedrock of secure income, the adviser increases their capacity for loss and therefore a more aggressive approach to risk can be adopted with the flexible assets. A further option is to phase retirement (see below for more details). This is becoming more and more common nowadays as flexible working patterns become more commonplace and many retirees are opting to gradually reduce hours and 'transition' into retirement as an alternative to the traditional cliff-edge scenario. This can help sustainability by reducing their reliance on the portfolio in the early years of retirement.

2.5 Phased Retirement

Phased retirement is used by clients who wish to start working part-time or to gradually cut back on their working hours until they decide to retire completely. At this stage, it would be necessary for the financial planner to review the client's current spending requirements and determine any shortfall. It could be the case that the reduced income is matched by a reduction in spending. If a gap has been identified, the following options (covered in more detail in chapter 3) may be used to supplement the client's current income:

- phased annuity purchase
- phased flexi-access drawdown and phased capped drawdown if that was in place prior to April 2015
- uncrystallised fund pension lump sum (UFPLS).

Phasing retirement using annuities works by crystallising funds, 25% of which is paid tax free, and the balance is used to buy an annuity.

Flexi-access drawdown works in a similar way as the member crystallises funds to place into the drawdown pension, with the pension commencement lump sum (PCLS) providing a tax-free amount.

Alternatively, a UFPLS can be taken from uncrystallised funds to provide a lump sum: 25% is paid tax free, with the remaining 75% taxed at marginal rates.

The goal is to provide the income that is needed to replace the income lost due to a reduction in working hours.

Taxable withdrawals can be taken where someone has unused personal allowance, and tax-free PCLSs can be taken to provide any excess.

Example

Alison is looking to reduce her working hours. She is currently aged 55 and has a personal pension with a fund value of £250,000. She wants to retire completely when she is 60 and, in order to replace the income, she will lose by working less she needs to generate a net income of £10,000. She can do this by either taking a PCLS or a UFPLS.

When she eventually finishes work, she will still have the option of buying an annuity to provide a guaranteed income.

Phased retirement is useful for those wishing to have control and flexibility over their pension fund. Tax-free cash can be used as income, while the balance of the fund remains invested. Annuity rates may also improve as the individual gets older, or enhanced annuity rates may become available.

2.6 Pension Fund Commutation

As we have already seen, following the pension freedoms in 2015, a scheme member is able to take their entire DC pension as a lump sum in the form of an UFPLS should they wish to do so. However, there are other circumstances in which a pension may be commuted entirely for a lump sum. The main ones which a planner should be aware of are as follows:

- **Trivial commutation lump sum**
  A trivial commutation lump sum can only be paid from a defined benefit (DB) scheme, or a money purchase in-house scheme pension, given the availability of a UFPLS from DC schemes. In order to be eligible, the following criteria must be met:
  - The member's total pension benefits (including the cash equivalent of the DB pension) must be less than £30,000.
  - The scheme rules must allow for the payment to be made.
  - The member must have reached their minimum pension age.
  - The payment must totally extinguish the member's right to benefits under the scheme.
  - The member must not have taken a previous trivial commutation lump sum over 12 months ago.

  The advantage of a trivial commutation lump sum is that it is not a relevant benefit crystallisation event (BCE) and is not tested against the lump sum allowance (LSA). Nor does it trigger the money purchase annual allowance (MPAA) Income tax treatment is standard, 25% of the lump sum is paid free of tax, with the remainder taxed as income in the year the lump sum is taken.
- **Small pots lump sum**
  A small pots lump sum requires the total value of the pension to be less than £10,000. An individual is entitled to take up to three personal pensions as small pots lump sums, together with an unlimited number of occupational ones. The criteria for taking a small pots lump sum are broadly similar to a trivial commutation lump sum. The main differences are that a member is able to take small pots lump sums at any time of their choosing the payment is not tested against the lump sum allowance and nor is the member required to have any lump sum allowance remaining.

  The latter is a key point – essentially, it allows scope for members who have already exceeded their LTA to take the pot without incurring an LTA excess tax charge. It should be noted that, aside from the 25% which is free of tax, the remainder of the payment will be subject to income tax in the normal manner.
- **Serious ill-health lump sum**
  A serious ill-health lump sum is payable in the event that the member has been medically diagnosed as having less than 12 months to live. The major advantage of this type of payment is that it is made completely free of income tax where the member is under the age of 75. The payment is, however, subject to an LTA test. Where the member is over the age of 75, there will be no such test, however, any payment will be taxed as income in the usual manner. Note that a serious ill-health lump sum can only be paid from uncrystallised funds.

- **Winding-up lump sum**
  A winding-up lump sum can only be paid where the scheme is an occupational one which is being wound up by the sponsoring employer. The main point to be aware of with this kind of payment is that it is not subject to age restrictions and can be taken before the normal minimum pension age. In order to qualify, the payment must extinguish the member's right to benefits under the scheme and the total value of the rights must not exceed £18,000. Where the fund is uncrystallised, 25% of it may be taken tax free, with the remainder taxed as income. Otherwise, the full value will be taxed as income.

2.7 Defined Benefit Transfers

Some clients may, in addition to their workplace defined contribution plans, have accrued entitlement to one or more defined benefit pension schemes.

The view of the regulator is that most members with such entitlements will be best advised to remain in their scheme. Such an arrangement can provide a valuable entitlement to secured income for life. This can help reduce reliance on the investment portfolio, mitigate sequencing risk and increase capacity for loss.

However, members with a defined benefit entitlement do have a statutory right to accept to accept a cash equivalent transfer value to transfer to a personal pension. Where the transfer value exceeds £30,000, there is a lawful requirement for the member to take financial advice, which must be provided by a qualified pension transfer specialist.

A detailed evaluation of the defined benefit transfer advice process is beyond the scope of this text. However, some of the main reasons why a member may consider a defined benefit transfer are as follows:

- The flexibility to take a pension commencement lump sum without needing to draw an income.
- The flexibility to tailor income according to needs including potential phasing of retirement and tax planning.
- Ability to use the pension as a tax-efficient legacy planning tool.
- High transfer values on offer until recently meant the transfer was good value and potentially a higher tax-free PCLS available.
- Some members had concerns about the security of their scheme, although the FCA has stated that it does not consider this a good reason to advise a transfer due to the availability of the Pension Protection Fund.

Recently transfer values have fallen significantly as a result of the steep rise in interest rates. Transfer activity fell to 7,181 cases in 2023/24, from a peak of over 100,000 around the turn of the decade. It is likely that pensions being brought within the estate for IHT purpose will serve to reduce the attraction further.

Where advising on a transfer, the adviser is expected to evidence:

- that the firm has assessed the client's key objectives in retirement;
- the objectives are specific, measurable, achievable, relevant and timely (SMART);
- the objectives are prioritized and any conflicts or trade-offs identified;

- the adviser has assessed the objectives as reasonable in view of the client's overall financial position;
- the existing scheme is not capable of meeting the client's objectives or that the transfer helps them to do so in a more complete manner;
- appropriate consideration of possible alternative means of meeting the objectives and why transferring the defined benefit scheme is the most appropriate option;
- where there are multiple schemes, whether it is necessary to transfer all, or whether the objective could be met by transferring a single scheme/ where partial transfers are available whether this may be a more appropriate alternative.

The adviser also needs to considers the risks to the client as a result including:

- **Investment risk** – the exposure of the value of their fund to fluctuations in markets and capacity for it to be reduced by adverse movements and suffer day-to-day volatility.
- **Transfer risk** – the risk to the fulfilment of the client's financial obligations imposed by the loss of a secure, guaranteed income for life.
- **Inflation risk** – the potential for the increasing cost of living to reduce or eliminate any investment gains in real terms. This is a specific concern in the current climate of inflation rates in double figures. By contrast, defined benefit schemes are usually protected against inflation, though to what degree depends on a number of factors including when the client left, the rules or the scheme and whether the benefits are in deferment or in payment. In practice, most schemes are unlikely to offer 100% uncapped inflation protection.
- **Longevity/mortality risk** – the danger of the client, ultimately, outliving their money. This becomes more pronounced the longer the client lives as they are likely to spend more time in less than perfect health and care costs are likely to become a factor.
- **Sequencing risk** – the risk of an unfavorable series of returns in the early years of the drawdown contract having a disproportionate impact on the client's future security.
- **Annuity rate risk** – the risk of annuity rates having fallen if the client decides at a later date that they would like to purchase a secure income.

2.8 Provision for Dependants and Long-Term Care

Providing for dependants, whether they be a spouse, civil partner or children, begins with a conscious decision to either transfer wealth or to use certain protection and financial products already covered in other sections of this workbook. For example, some options available to clients concerned with providing their spouse, civil partner or children with an income when the client dies include:

- buying an annuity with guarantees or spouse benefits built in
- flexi-access drawdown where, following the client's death, the remainder of the fund can be left to the dependants, or
- a life insurance policy that pays out on death.

Careful estate planning is also a useful tool when providing for dependants. The aim, generally, is to maximise the after-tax value of assets transferred. Gifts, trusts and other transfer mechanisms can be used; however, the advantages, disadvantages and tax implications will need to be considered.

Other reasons to review the investment strategy include when the client decides to draw their state pension, if the client's health changes, if their circumstances change (for example, the death of a spouse or a dependant) or when they are aligning their overall financial plan to provide for long-term care costs.

Long-term care can be difficult to plan for as there is great uncertainty in terms of if, when and for how long care will be required. The methods available for planning ahead are limited as, at present, there are no specific long-term care products. As an estimate of potential costs, research conducted published in July 2023 revealed that the average cost of being in a UK care home was £58,746 per year, rising to £69,083 if nursing care was also required. The costs, however, did vary significantly, with homes in London and the southeast being markedly more expensive.

If the client wishes to plan for long-term care, the financial planner should look at possible capital protection products as a means of setting aside funds for care and building up sufficient assets to pay for future care fees, using the products outlined previously in this chapter.

If the need for long-term care is immediate, then an immediate needs annuity can be bought which in exchange for a lump sum provides a guaranteed annuity income.

2.9 Investment for Legacy Planning

The use of measures such as gifting and loan trusts are a well-known part of inheritance tax planning. However, it is also possible to utilize investment-based solutions to achieve the same end.

Inheritance tax relief applies to qualifying shareholdings in private limited companies in the form of what is known as business relief. There are a number of providers, such as Foresight, Triple Point, Octopus and Downing, who offer specialized inheritance tax solutions. These are structured as private limited companies, but undertake low-risk trading activities, often concerned with infrastructure and energy but offering long-term contracts and stable revenue streams.

Investment in such offerings meets the qualifying criteria for inheritance tax relief. However, following the autumn budget 2024, it was announced that with effect from April 2026, such relief would be limited to £1m worth of assets per person, which served to reduce their attractiveness to a degree.

A further alternative is to invest in the alternative investment market (AIM) portfolios offered by some providers. These invest into shares which are listed, but as they are not on the main market, remain eligible for business relief. The volatility of these products may make them less desirable for those with cautious risk profiles and again, following the autumn budget that IHT relief will be limited to 50%, their attractiveness may reduce in future.

Agricultural property is another asset which has historically benefitted from an exemption from inheritance tax by way of agricultural property relief. This has historically meant that farm land has been able to be passed through the generations free of tax liability.

Following the announcements in the autumn budget, this will also be limited to £1 million per person with effect from April 2026. The government has faced some criticism from the industry over this measure. However, given that the allowance applies in addition to the standard and main residence nil rate bands, farm owners will potentially be able to pass up to £3 million worth of assets on before being impacted by the charge.

Farm assets above the limit will be subject to IHT at a reduced rate of 20% as opposed to the usual 40%. Provisions have also been announced to allow staged payment over a period of up to ten years rather than payment of the full amount upfront.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **Identify important factors to consider when establishing retirement aims and objectives.**
   Answer reference: Section 1.1.1

2. **Give two advantages of using equity release to provide a retirement income.**
   Answer reference: Section 1.3.1

3. **How long must a business or shares in a business be owned for to qualify for Business Asset Disposal Relief (BADR)?**
   Answer reference: Section 1.3.2

4. **What is the maximum contribution into a Lifetime Individual Savings Account (LISA)?**
   Answer reference: Section 1.3.5

5. **Give three examples of products which may be covered under the term 'alternative investments'.**
   Answer reference: Section 1.3.6

6. **What is the tax position of dividends from a UK equity unit trust?**
   Answer reference: Section 1.3.11

7. **In what circumstances may a scheme member take their pension before the age of 55?**
   Answer reference: Section 2.1

8. **What are the four investment pathways?**
   Answer reference: Section 2.3

9. **Explain three strategies for mitigating sequencing risk.**
   Answer reference: Section 2.4

10. **Outline the criteria for a trivial commutation lump sum to be paid.**
    Answer reference: Section 2.6

11. **What are the current rules regarding who must take and who can give pension transfer advice?**
    Answer reference: Section 2.7

12. **What are the changes to the inheritance tax regime due to take place from April 2026?**
    Answer reference: Section 2.9

Chapter Five

Financial Planning Recommendations

1. **Develop Financial Planning Recommendations** 259
2. **Implementing Financial Planning Recommendations** 264
3. **Reviewing the Client's Situation** 268

This syllabus area will provide approximately 8 of the 80 examination questions



1. Develop Financial Planning Recommendations

Learning Objective

5.1.1 Understand how to develop recommendations; explain and justify outline recommendations to meet/address client needs, goals, objectives, and other issues or problems where appropriate; draft initial recommendations for a suitable financial plan

5.1.2 Be able to evaluate the advantages and disadvantages of different strategies

5.1.3 Be able to evaluate whether all recommendations are suited to the client's situation and financial requirements, including: appropriateness and relevance of proposed solutions, products and, where applicable, providers; alternative courses of action where no suitable product is available; whether they match the client's agreed risk/reward trade off; affordability

5.1.4 Be able to analyse the requirement to appropriately balance the interrelationship between protection, saving and investment, and other objectives such as liquidity and retirement

1.1 Developing Recommendations

The fundamental aim of financial planning is to make recommendations that meet the client's current and anticipated needs, allowing them to make use of funds when needed, protect both their lifestyle and their family and achieve this in a manner that is affordable.

We have already considered the fact that objectives should be prioritised and matched to a client's

financial situation. An important role of the financial planner is to guide the client to the best solutions, particularly when they have a limited budget.

In some cases, solutions will come from a combination of the various protection and retirement products and investments covered in chapters 2, 3 and 4 of this workbook. In other cases, a simple rearrangement of the clients' affairs may be sufficient to help them to achieve their goals and objectives. Quite often the financial plan and recommendations will involve a combination of products and a rearrangement of the client's finances.

The financial planner needs to ensure that they follow a systematic process for developing recommendations as these will need to be justified to the client when presenting the financial plan. The following steps are, therefore, seen as best practice when developing recommendations:

1. Identify objectives (at this stage the objectives should be specific, measurable and timescales should have been assigned).
2. Identify alternative products, investments or strategies to achieve the objective.
3. Evaluate each alternative by considering:
   - suitability based on the client's situation (eg, risk tolerance, capacity to loss and affordability)
   - costs and benefits (quantified as far as possible)
   - where an investment product is recommended, it should match the level of risk the client is prepared to take for the expected return
   - affordability
   - qualitative advantages and disadvantages
   - knock on effects on other recommendations, and
   - other relevant factors (eg, when selecting a life insurance policy, look at the pros and cons of selecting one provider over another).
4. Select the most appropriate alternatives based on the evaluation performed at stage three and document justifications.

Where no suitable product is available, no recommendation should be made, but alternative courses of action could be explored. This is particularly applicable when it comes to providing for long-term care as the availability of protection products in this area is almost non-existent.

The firm should have a process in place to ensure that the sale of a product is not required in order to receive fees.

1.1.1 Prioritisation of Needs and Objectives

The financial plan will look at the client's circumstances from a holistic viewpoint, rather than treating each issue, goal or objective in isolation. It is, therefore, important, when developing recommendations, that the financial planner considers how a recommendation in one area will have an effect on another area. For example, the payment of long-term care fees from accumulated assets may have the effect of reducing the value of the estate for inheritance tax purposes on the client's eventual death.

Ultimately, the recommendations need to appropriately balance the interrelationship between the client's various objectives. These may include protection, saving and investment, and other objectives such as liquidity and retirement.

The planner needs to be able to recognise that each client only has a finite amount of surplus income after their essential living expenses, such as mortgage or rent, food, council tax and utility bills are paid. They will also, in most cases, only have a finite amount of capital. The financial planner needs to consider the most appropriate method to utilise these resources in order to meet as many of the client's needs as possible, whilst ensuring that the most urgent ones are prioritised.

Generally, where a client has surplus income after essential living expenses, arranging appropriate protection cover is considered a top priority. What constitutes appropriate cover may vary according to the client and their personal circumstances; however, for people of working age, income protection and/or critical illness cover, it would normally be considered at the top of the priorities list.

For those with young families, life cover is also essential in order to repay their mortgage and/or replace any lost income in the event of their untimely death. Should the client have unsecured debts, such as personal loans or credit cards, then repayment of that borrowing would also be a high priority, since the interest rates charged are often substantial.

Subject to having a satisfactory emergency fund, pension provision would generally be considered the next priority, followed by non-pension saving and investment. However, some clients may also view early repayment of their mortgage as a high priority. Others may have a particular need for liquidity which would make pension saving less attractive. Considering and prioritising these objectives is a delicate balancing act and requires a thorough analysis of the client's circumstances and the soft facts.

Example

A client who receives statutory sick pay only would normally look to secure appropriate income protection as a high priority, assuming health is good and cover can be obtained. This would usually be the planner's primary recommendation for use of any surplus income. Were the client to have a group income protection plan arranged by their employer covering them to normal retirement age, this would cease to be a priority, at least whilst the client continued to work for the employer.

However, were the group scheme an accident and sickness one with a finite limit, for example two years, there is a discussion to be had over the potential benefits of taking out a personal income protection policy with a two-year deferred period to cover any long-term incapacity. The value of this needs to be weighed up against other desirable needs such as paying off the mortgage, or increasing pension provision. As a general rule, the closer the client is to retirement, the more desirable the latter options may seem.

When presenting the recommendations to the client, the financial planner must be able to justify each one by explaining any advantages and disadvantages they may have. Any relationship or correlation between products or services must also be fully explored and explained.

Mortgage planning, investing and retirement planning must also be carried out in the context of the wider economic environment. Interest fluctuations as well as rates of inflation have a marked effect on the future value of savings and on the current or future cost of borrowings.

Large increases in the repayment amounts of borrowings will have a significant impact on the client's financial position. Economic factors can also affect the stability of a client's income (eg, the effect of redundancy). Matching any investments chosen to the economic climate at the time, and explaining the rationale for this to the client is essential.

1.1.2 Initial Recommendations

Initial recommendations can be drafted following the completion of the process above. As a minimum, initial recommendations should contain:

- an outline of the specific objectives to be met
- a brief outline of the products, investments or strategies being recommended, and
- reasons why the financial planner has concluded that the recommendations might be suitable.

These recommendations will be presented to the client prior to the development of a comprehensive financial plan. The aim is to ensure that the financial planner has correctly identified and prioritised the client's objectives, and that the client understands and is in agreement with the recommendations. Presenting the client with initial recommendations provides a valuable opportunity to clarify any misunderstandings. In addition, these initial recommendations lay the foundation for further analysis and the production of the financial plan.

Additional detail required when drafting final recommendations include:

- relevant financial projections, illustrations and cost estimates, eg, premiums for insurance products
- any knock-on effects of recommendations
- possible disadvantages associated with the recommendations, and
- any shortfall in meeting objectives.

There may be numerous occasions during a client's life cycle when they may need to evaluate a number of different strategies to consider what is the most effective means of meeting a need. Examples might

Example

Sid is aged 63 and planning to retire. He has a defined contribution pension fund worth £700,000 and no defined benefit entitlements. He is single and in good health. Sid would like to access a tax-free lump sum to help pay off his mortgage and draw a flexible income from the remainder. He has a moderate risk tolerance and expects to live comfortably in retirement, but values flexibility and estate planning options. As of 6 April 2024, the Lifetime Allowance (LTA) has been abolished. Sid's tax-free lump sum is now limited by the Lump Sum Allowance (LSA), currently £268,275.

Sid chooses to take the full 25% tax-free lump sum: £175,000. The remaining £525,000 is moved into flexi-access drawdown. He plans to take £2,000 per month initially, subject to investment performance. As Sid accesses income flexibly, the Money Purchase Annual Allowance (MPAA) of £10,000 applies to future pension contributions.

The main factors, advantages and disadvantages that Sid will need to consider in making his decision are as follows:

Relevant consideration	Annuity	Flexi-access drawdown
Security of income	Will provide a secure income for life.	Income will be dependent on markets. Sustainability will need to be monitored.
Inflation	May opt for inflation protection, but will reduce rate.	Investment return will need to exceed inflation.
Flexibility	Not normally available, decisions made at outset.	Can vary income to suit needs, likely to be useful when state pension becomes available. Can also take ad-hoc lump sums to gift to children.
Advice costs	May require advice at outset.	Likely to require ongoing advice.
Investment risk/ return	No investment risk but cannot benefit from returns.	Subject to investment and sequencing risk. Can benefit from strong returns.
Future options	Usually irreversible.	Annuity purchase at a later date is an option if needed.
Cross-subsidy	Mortality gain.	Mortality drag.
Death benefits	Depends on selection at outset, may include guarantee/ spouse's pension.	Remaining fund can be left tax-free on death prior to age 75.
Protection	100% FSCS as an insurance product.	May be limited depending on holdings.

Note that this is not necessarily a binary choice. Sid does have the option of using part of his pension fund to purchase an annuity to increase his secure income while placing the balance into drawdown. This is something that his adviser will need to explore when advising him on strategy.

2. Implementing Financial Planning Recommendations

Learning Objective

5.2.1 Be able to evaluate how the plan and/or recommendations meet the client's specific needs, in a manner that the client can understand, including: explanation of appropriate financial protection products to the client and how they meet client needs; appropriateness and suitability; characteristics, correlation, advantages and disadvantages of different products; comparison of the different options available; implications of the different recommendations on other parts of the financial plan; advantages and disadvantages of the proposed recommendations including costs; how the recommendations take account of future needs; how the recommendations will be handled, including the need for monitoring and review

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The financial plan is a client-specific document which broadly sets out the following:

1. The client's current financial position.
2. The client's objectives (with an indication of priority).
3. The client's risk tolerance level.
4. Specific considerations (eg, interests in ethical investing).
5. Recommendations for the achievement of objectives.

A well-constructed financial plan can serve as a document of understanding that protects both the client and the financial planner. It is, therefore, essential that the financial planner is able to demonstrate why the recommendations are suitable to the client's needs.

Implementing financial planning recommendations involves communicating and justifying the recommendations within the financial plan to the client in a clear and understandable manner. Essentially, this involves explaining and illustrating how the final recommendations presented in the financial plan meet the client's needs.

Implementing financial planning recommendations should not be confused with implementing the financial plan itself.

2.1 Evaluating Recommendations Against Objectives

Note that the financial planner, in arriving at their final recommendations, would have already gone through the process of looking at alternative options and evaluating the suitability of each one in light of the client's circumstances. If this process was performed in a systematic manner, the financial planner would have documented reasons for accepting and rejecting options.

Implementing financial planning recommendations takes on a similar format to presenting initial recommendations, as covered in section 1. However, at this final stage, any questions or views that the client would have expressed during the initial recommendations stage should have been addressed by the financial planner. Note that the client would have had an opportunity to consider what was presented in the initial recommendations, and should now have a better overall understanding.

In addition to the details contained in the initial recommendation (which should have been updated by the financial planner by this stage to reflect any changes), the financial planner will need to provide information to the client that allows them to easily navigate the various options presented, gain a thorough understanding of the risks and costs associated with these options, appreciate the correlation between products, investments and strategies recommended, and how these will affect the future value of the client's portfolio of assets. Some additional illustrations and documentation that may be useful to facilitate this are covered below:

2.1.1 Suitability Reports

The minimum content as prescribed by the Financial Conduct Authority (FCA) includes:

- specifying the client's demands and needs (objectives)
- explaining why the recommended transaction is suitable having regard to the information provided by the client, and
- explaining any possible disadvantages of the transaction for the client.

Under the FCA's rules, firms should provide appropriate details according to the complexity of the transaction. Firms are only obligated to provide suitability reports in certain circumstances, however these are a useful tool for communicating why recommendations are deemed suitable and could be provided to clients even in situations where the rules do not dictate that they are necessary.

A suitability report is not required for an increase in a regular contribution to an existing life policy but is required for the other situations such as changing funds or switching.

2.1.2 A Key Features Document (KFD)

Firms providing non-packaged retail and insurance-based investment products (non-PRIIPs), cash-deposit individual savings accounts (ISAs) and cash-only lifetime ISAs (LISAs) are required to produce a key features document (KFD) for each product offered. These contain information about the nature and complexity of the product, how it works, any limitations or minimum standards that apply and the material benefits and risks of investing. These are aimed at retail clients to allow them to make informed decisions.

2.1.3 A Key Information Document (KID)

A key information document (KID) is required to be provided where a firm sells a PRIIP. This is a three-page document which provides key information regarding the product. The manufacturer is required to produce one for relevant products and to make it available on its website. A firm selling the product is required to provide a copy to the client in good time prior to the conclusion of the transaction.

The document provides certain essential information relevant to the product in a highly prescribed format. This includes the risks associated with it, costs, access terms, how to complain and what happens if the manufacturer is unable to pay out.

2.1.4 A Key Features Illustration (KFI)

Firms must prepare a key features illustration (KFI) for each non-PRIIP packaged product they produce. These cover the premium or investment; any guaranteed benefits, (ie, sum assured) a projection of the final benefit based on the FCA-specified assumed growth rate, and the effect of charges and any commission payable to the adviser.

PRIIPs include:

- structured financial products, such as options, which are packaged in insurance policies, securities or banking products
- financial products whose value is derived from reference values such as shares or exchange rates (derivatives)
- closed-ended and open-ended investment funds
- investment-type insurance products, such as with-profit and unit-linked life insurance and hybrid products, and
- instruments issued by special purpose vehicles.

Other useful documents include relevant product marketing literature and the cancellation or cooling off details of products.

In addition, any cost benefit analyses, personal budgets or cash flow forecasts produced by the planner will be useful in justifying recommendations to the client.

Once the financial planning implementation process is complete (ie, once the recommendations have been explained to the client with supporting rationale), the financial planner will then agree on implementation responsibilities with the client. Some responsibilities will lie with the planner, while others will lie with the client.

It is, therefore, good practice to produce an action list highlighting the recommendations, related actions, next steps required, who is responsible for implementing those steps, and a target date for completion. An example is provided below (note that the clients, Karl and Ulrika, are a married couple).

Example

Action	To be completed by:	Completion timescale:
Open an instant access deposit account each with an investment of £3,850	Karl and Ulrika	Within two weeks
Check that there is no notice period required regarding the reallocation of cash deposits	Karl and Ulrika	Within two weeks
Contact a solicitor to: • rewrite wills • set up lasting powers of attorney (LPAs), and • set up a discretionary trust to receive the imminent inheritance now (you should obtain details of the costs of running such a trust before proceeding with any alteration in your will) and sever the tenancy of your house from joint tenants to tenants in common with the shareholding split 50:50	Karl and Ulrika	Within two weeks
Sell your gilts	Karl and Ulrika	Within one month
Investigate the suitability of the with-profit and distribution bonds and recommend disposal if appropriate	Planner	Within three weeks
Invest the remaining balance of your portfolio split 60% cash and fixed interest and 40% global equities; split ownership 50:50	Planner	Advise individual holdings within two weeks, implement within one month
Arrange Royal National Lifeboat Institution (RNLI) donations under gift aid	Karl	Within two months
Investigate the potential to pre-pay remaining school fees using the inherited monies	Planner	Within one month
Use a deed of variation to redirect the inheritance from Karl's estate into a discretionary trust to pay the school fees and other items in the future	Karl	Prior to the arrival of the inheritance
Invest the proceeds of the inheritance in the discretionary trust portfolio once we have discussed your attitude to risk for this in more detail	Financial planner and trustees	When the inheritance arrives and shares have been sold
Pay Ulrika's school fees as they arise from your discretionary trust portfolio	Trustees	From September 2021

In addition to the above, the financial planner must set out and agree with the client terms for reviewing and re-evaluating the financial plan.

3. Reviewing the Client's Situation

Learning Objective

5.3.1 Understand how to conduct financial planning reviews and review meetings, including: purpose and frequency of reviews; process of reviewing a financial plan; initiating a review meeting and gathering the data required; what is discussed at a review meeting

5.3.2 Be able to analyse actions that may be required after the review, including: reassessing and rebalancing asset allocation; review of existing financial solutions

3.1 The Purpose and Frequency of Reviews

Ultimately, the objective of each review is to inform the client as to whether they remain on track to meet their objectives and, if not, what additional actions may be required. Regular reviews will also present an opportunity to build client trust and confidence in the service being provided by the financial planner.

The overall purpose of financial planning reviews is to:

1. establish whether the client's situation (such as objectives and risk profile) has changed since the plan was set or since the last review
2. review the plan to assess progress in meeting objectives
3. assess whether recommendations are still valid, and
4. agree any necessary modifications or revisions to the financial plan.

Although there is no set interval between review meetings, a financial plan should generally be reviewed at least every 12 months. It is a requirement under the Markets in Financial Instruments Directive II (MiFID II) that portfolio suitability be reviewed no less frequently. However, ad hoc reviews may also be required if there is a significant change in the client's circumstances, or for other reasons, such as during periods of extreme market volatility or changes to tax or pensions rules.

3.2 Initiating the Review Meeting and Gathering Data

The terms of review would have been agreed in advance with the client. This means that the client should have a rough idea as to the timings of the reviews. It is good practice, however, to send a reminder confirming the date and time and whether they will be able to attend the review; this will be done via the client's preferred method of communication.

In preparation for the review, it is also good practice to ask the client if there have been any significant changes to their circumstances that the financial planner needs to be aware of. If this information is gathered in advance of the review, the financial planner will have time to assess the impact on the current recommendations and draft revisions and solutions. In some circumstances, a modified version of the documents used during the initial fact find could be sent out to clients to be completed.

The financial planner needs to ensure that they are sufficiently prepared for the review and, should therefore, create a checklist that covers all pre-meeting activities. Items to include are as follows:

- Send out invitation and relevant documents to the client (eg, updated data gathering form).
- Ask if the client has any particular agenda items that they wish to discuss.
- Look for action items that are still pending.
- Obtain performance data on investments so as to assess performance in view of the client's objectives.
- Review the client's need for protection products and assess the suitability of current products.
- Identify new products on the market that may be more suitable.
- Identify any tax and pension rules, allowances, or rates that may affect the client.
- Obtain information on changes to economic assumptions that were used in the financial plan, eg, gross domestic product (GDP) growth, inflation rates, interest rates.
- Review the financial plan.
- Send out a finalised agenda.

On occasion, the client may decline a review or simply refuse to participate in the process. While the advisory firm cannot necessarily prevent this or compel the client to take part, it does make it harder to ensure that the existing plan remains appropriate for the client.

The firm should clearly record on the file in such circumstances that the client declined the meeting and the reasons for this. It ought to at least request that the client advise whether there have been any material changes to their circumstances or objectives. The planner ought to consider carrying out an internal review of the client's arrangements in order to proactively review whether any changes are desirable.

The firm should also consider advising the client that the ongoing review process cannot take into account any changes in their situation which are not advised to the planner.

3.2.1 Reviewing the Plan

Once relevant data has been gathered (as outlined above), the next step is to conduct an initial review of the financial plan in preparation for the meeting. Factors to consider are summarised in the table below. For each factor, the financial planner must consider the effect on the client's financial plan.

Factor	Considerations
Changes to the client's situation	• Have there been any significant changes in the client's life such as career or job changes, health issues, or family developments, (eg, a child on the way, the death of a spouse or the care of elderly parents)?
Changes to goals and objectives	• Has the client changed their retirement plans in any way? • Are there any changes in the target value of retirement assets?
Net worth, income and expenditure	• Has the client's income increased or decreased? • Is there a need to recalculate net worth and cash flow projections? • Do budgets need to be revised?
Client risk profile	• Are there any indications that the client's risk profile has changed? • Has the client's attitude to risk changed since the creation of the plan or since the last review? • Has the client entered a different stage of their life cycle? For example, have they moved from early accumulation to late accumulation?

Example

Enrique and Maria are aged 48 and 46, married with three children aged 15, 13 and 8. They have a longstanding relationship with their financial planner Julie.

Following a difficult few years, Enrique contacts Julie to adviser her that he and Maria have decided to divorce. He requests that the advice firm separate his affairs from hers and that at his next meeting, they consider the implications for his financial planning.

This throws up a few aspects for Maria to consider. Firstly, is it possible for her to continue to provide advice to both Enrique and Maria? Might it be better to look to reassign one of them to another planner if possible in order to mitigate potential conflicts of interest?

Secondly, what are the key implications for their financial planner? Matters such as their wills, insurance cover and pension death benefit nominations will all need to be reviewed to ensure ongoing suitability. Who is going to keep the marital home and what are the proposed living arrangements for the other. What are the custody arrangements for the children? How, if at all, are pension arrangements going to be split? What about the other assets of the marriage?

Factor	Considerations
Asset allocation and rebalancing	• Is there a need to rebalance the client's investment portfolio? For example, the client's asset allocation may have started the year with a 50/50 split between shares and government bonds, but because of changes in asset prices, the ratio may have now changed to 40/60. This will indicate a need to rebalance. • Is the current asset allocation still suitable for the client's situation? Recall that, as the client gets older, the portfolio's weight in risky assets should be reduced. • Is this the right time to change the client's asset allocation? • What costs and taxes will be incurred in rebalancing?
Investment performance	• How have the assets actually performed in comparison to target returns? • What should the strategy be if targets were exceeded? For example, if performance is better than expected, the financial planner may decide to either reduce risk as the client's portfolio now requires lower returns going forward, or they could increase risk since the client has greater capacity to absorb losses. This will depend entirely on the client's circumstances and stage of life. • What should the strategy be if targets were not achieved?
Insurance cover	• Have needs changed? • Have claims been made and premiums increased as a result? • Are current products still suitable? • Will the client get a better deal from another provider? • Are there any affordability issues to consider? For example, can the client still afford premiums on dental insurance? Alternatively, the client may have more funds and may have wanted to take out critical illness cover (CIC), but could not afford to do so previously; will this be possible now?
Suitability of products	• Are these (eg, premium bonds and product wrappers (eg, ISAs) held) still suitable? • Have any of these matured and need to be rolled over? • Are there any new products in the market that the client could benefit from?
Underlying assumptions	• Review and amend the assumptions used in the financial plan to take account of changing market conditions, investment returns and future inflation rates.
Tax and pension regulations	• Have there been any changes to tax and pension rules that will affect the client's financial plan? • For example, are there any new tax wrappers that may be suitable? Changes to state pension age (SPA)?

Example

Yolanda is aged 62 and has always had a relatively cautious attitude to risk, which has been exacerbated in recent years as she approaches retirement, which she would like to take place at age 65. At her most last annual review meeting, it was determined that a 50% weighting towards blue chip equities was considered appropriate for her portfolio, valued at £500,000. Her asset allocation was therefore as follows:

Asset	Weighting	Value
Equities	50%	£250,000
Government bonds	15%	£75,000
Corporate bonds	20%	£100,000
Property	10%	£50,000
Alternative investments	5%	£25,000
Total	100%	£500,000

Due to economic circumstances, over the last year, there has been a flight to quality in the equity markets and a significant increase in interest rates available on the market. Therefore, the value of her equity holdings has risen significantly and her fixed interest holdings have dropped in value. Her portfolio now shows the following:

Asset	Weighting	Value
Equities	58%	£300,000
Government bonds	13%	£65,000
Corporate bonds	16%	£85,000
Property	8%	£44,000
Alternative investments	5%	£26,000
Total	100%	£500,000

Yolanda's financial planner may now need to consider rebalancing her portfolio as the market movements over the past year mean that her equity weighting is now 8% over the target agreed at the last meeting.

In some cases, significant changes to one or more of the above may require that a new financial plan is drafted; in others, the existing plan may be amended and updated. It is important that the client fully understands how the financial plan works and how it will help them to meet their objectives.

3.3 Conducting the Review Meeting

Once the financial planner has carried out sufficient preparation as outlined in the sections above, the review meeting should run smoothly. The review meeting should be viewed as a formal or professional conversation and should follow these stages:

- **Stage 1 – Welcome the client and set out the agenda** – the success of the meeting will be significantly influenced by the manner in which it is started. The idea is to provide a structured approach to the meeting and the review. If the agenda is clearly set out, the client will know what to expect and will, therefore, be able to raise concerns and questions at the appropriate time. With a clear agenda, the financial planner will ensure that all areas for consideration and discussion are covered.
- **Stage 2 – Performance review and progress update** – provide the client with an overall view of whether the assets have performed in line with expectations. Explain any reasons behind good and poor performance. How much detail you go into will depend on the client, their level of understanding and what questions they ask. It is good practice to have performance data readily available, either in hard or soft copy format. Firms are also required to provide a breakdown of adviser charges and product costs at each annual review meeting.
- **Stage 3 – Discussion of changes in the client's situation** – the discussion will cover the implications of changes in circumstances already brought to the attention of the financial planner and other factors the client now considers important. The financial planner must ensure that they ask the right questions, for example tactful questions about family, work, recreational activities and even pets tend to prompt clients to reveal relevant information.
- **Stage 4 – Update the client on changes to any tax or pension rules affecting them** – provide the client with a clear explanation of what these are and their potential implications. Some changes may be too complex and extensive to cover in the review meeting; for example, the rules on flexibly accessing pension assets at the age of 55. In such cases, if it will affect the client, another meeting may have to be arranged before recommendations can be developed.
- **Stage 5 – Discuss proposed changes to the plan in view of changes identified in stages 3 and 4** – all recommendations will need to be explained and justified, as was the case when the initial financial plan was created. Note that the client will have to agree to any revisions and new recommendations and may need more time to consider the proposals.
- **Stage 6 – Summarise, clarify actions and set out the next stages** – after the review meeting, update the actions list and circulate this to the client.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **What are the steps involved in developing recommendations?**
   Answer reference: Section 1.1

2. **What are the essential elements to be covered by initial recommendations?**
   Answer reference: Section 1.1.2

3. **What does implementing financial planning recommendations involve?**
   Answer reference: Section 2

4. **Outline the contents of a suitability report.**
   Answer reference: Section 2.1.1

5. **What are the main purposes of financial planning reviews?**
   Answer reference: Section 3.1

6. **What factors are considered when reviewing the financial plan?**
   Answer reference: Section 3.2.1

Glossary

Actuary
An independent person who is professionally qualified to give advice on the financial position of a pension scheme.

Additional Voluntary Contributions (AVCs)
Employee contributions over and above any compulsory contributions to a tax-approved workplace pension scheme.

Annual Allowance
The maximum tax-relievable amount that can be contributed by a member, or employer on behalf of a member in a tax year, before liability to an annual allowance charge.

Annual Allowance Charge
The tax charge levied on a member of one or more pension schemes, whose total contributions made by the member, or on their behalf by an employer or other party, exceed the annual allowance. The excess is subject to the annual allowance tax charge.

Annuity
Income from a capital investment paid in a series of regular payments.

Appropriate Pension Transfer Analysis (APTA)
A qualitative analysis of the benefits, disadvantages and risks of each arrangement required of a pension transfer specialist when making a recommendation.

Auto-enrolment
UK employers must automatically enrol eligible jobholders into a qualifying pension scheme that meets minimum standards.

Benefit Crystallisation Event (BCE)
A defined event or occurrence that triggered a test of the benefits 'crystallising' at that point against the individual's available Lifetime Allowance during the period the allowance was in force.

Capital Gains Tax (CGT)
Tax paid on profits realised from selling assets (or disposing of assets) in a tax year. In the UK, there is an annual exempt amount. CGT is paid at rates determined by the taxpayer's income tax status.

Capped Drawdown
A type of income drawdown product available only to those who were already in capped drawdown on 5 April 2015. Withdrawals are subject to a maximum income level but not a minimum level.

Civil Partner
A person who has entered into a civil partnership.

Commutation (Conversion)
Immediate payment of a single sum to extinguish pension entitlement, either because the scheme member's pension is of a trivial value, or because the scheme member has a life expectancy of less than 12 months.

Also used to refer to the payment of a pension commencement lump sum (PCLS) from a defined benefit (DB) entitlement, where this is paid in exchange for a reduced starting pension.

Defined Benefit (DB) Pension Scheme
An arrangement other than a money purchase arrangement that provides only defined benefits. Defined benefits are calculated by reference to the earnings and service of the member, and are also known as final salary or career average revalued earnings (CARE) schemes.

Defined Contribution (DC) Pension Plan
A pension scheme in which the employer and employee agree on a set amount to be contributed to an individual pension fund. The contributions are invested to provide a fund on retirement. Unlike defined benefit schemes, the level of the member's retirement income is not guaranteed.

Dependants
People who were married to, or a civil partner of, the member at the date of the member's death. A child of the member is a dependant if they have not reached the age of 23, or has reached age 23 and, in the opinion of the scheme administrator, was at the date of the member's death dependant on the member because of physical or mental impairment.

A person who was not married to the member or was not in a civil partnership with the member at the date of the member's death and is not a child of the member is a dependant of the member if, in the opinion of the scheme administrator, at the date of the member's death:

- the person was financially dependent on the member
- the person's financial relationship with the member was one of mutual dependence, or
- the person was dependent on the member because of physical or mental impairment.

Dividends
A payment made by a company to its shareholders.

Domicile
In UK law, an individual has only one domicile. This is the country they regard as their permanent home. This is not necessarily the same as residence or nationality.

Drawdown Pension
A short-term annuity or income withdrawal paid to a member of a registered pension scheme.

Drawdown Pension Fund
A pension fund in respect of an arrangement consisting of the sums or assets held for the purposes of the arrangement.

Endowment Policy
A life assurance policy that pays out a sum assured on the death of the life assured, or at the end of an agreed term, whichever is the earlier. The money is traditionally invested in a range of securities, including equities. A traditional with-profits policy includes the addition of bonuses.

Enhanced Protection
This provided full protection against the lifetime allowance excess tax charge for the value of the whole of an individual's pension rights as at 5 April 2006.

Fixed Protection
Fixed protection 2012 maintained the lifetime allowance (LTA) of £1.8 million. Fixed protection 2014 maintained the lifetime allowance of £1.5 million. Fixed protection 2016 maintained the lifetime allowance of £1.25 million.

HM Revenue & Customs (HMRC)
The tax-collecting agency of the UK government.

Individual Protection
This gave individuals a protected LTA equal to the value of their pension savings as of either 5 April 2014 or 2016. This was subject to a maximum of £1.5 million for IP14 and £1.25 million for FP16.

Inflation
A measure of the rate of change in prices or earnings.

Inheritance Tax (IHT)
Tax paid on death or on some lifetime gifts subject to a threshold.

Liabilities
Money owed.

Lifetime Allowance (LTA)
The limit in existence between 2006 and 2024 on total pension saving payable from a scheme before an additional tax becomes due.

Lifetime Annuity
An annuity contract purchased under a money purchase arrangement from an insurance company of the member's choosing that provides the member with an income for life.

Lump Sum Allowance (LSA)
A limit on the amount of tax-free lump sums a member can take from their pension arrangements during their lifetime in place from the 2024/25 tax year. The limit will usually be £268,275, though may be higher if the member previously had lifetime allowance protection.

Lump Sum Allowance & Death Benefits Allowance (LSDBA)
A limit on the total that can be paid free of tax during the member's lifetime or on death before age 75. The limit is calculated with reference to the member's previous lifetime allowance.

Money and Pensions Service (MaPS)
The new name for the Single Financial Guidance Body (SFGB), a government run financial information and guidance body which unified and replaced The Money Advice Service, Pension Wise and The Pensions Advisory Service.

Money Purchase Annual Allowance (MPAA)
When the member has taken advantage of flexible access, for example by taking an uncrystallised funds pension lump sum, the member can only contribute £10,000 annually to a money purchase scheme. Unused MPAA from previous years cannot be carried forward.

Money Purchase Arrangement
An arrangement is a money purchase arrangement if, at that time, all the benefits that may be provided to or in respect of the member under the arrangement are cash balance or other money purchase benefits.

Money Purchase Benefits
Benefits provided under a pension scheme, calculated by reference to payments made under the scheme by the member or any other person or employer on behalf of the member, or any other factor.

Occupational Pension Scheme
A defined benefit or defined contribution registered pension scheme established by an employer or group of employers to provide benefits to, or in respect of any, or all of the employees of that employer or group of employers, or any other employer. This is now often referred to as a 'workplace pension'.

Opt Out
The facility for a person to formally opt out of auto-enrolment.

Overseas Pension Scheme
A pension scheme is an overseas pension scheme if it is not a registered pension scheme but it is established in a country or territory outside the UK and satisfies the requirements in the Pension Schemes (Categories of Country and Requirements for Overseas Pension Schemes and Recognised Overseas Schemes) Regulations 2006.

Overseas Transfer Allowance (OTA)
A limit on the amount that can be transferred to qualifying recognised overseas pension schemes without incurring a tax charge. This is calculated with reference to the previous lifetime allowance.

Packaged Products
Life policies, unit trusts or OEICs, investment trusts, stakeholder pensions or personal pensions.

Pension Attachment Order
A process by which some of the pension benefits due to a member are paid to the ex-spouse, as directed by a court at the time of a divorce, but are only paid when the member retires.

Pension Commencement Lump Sum (PCLS)
The tax-free lump sum which may be paid to a member on taking pension benefits.

Pension Credit
The amount of benefit rights that an ex-spouse or former civil partner becomes entitled to following a pension sharing order. Also an income-related means-tested benefit which boosts a pensioner's state pension to ensure they have a minimum level of income.

Pension Credit Member
Former spouse or former registered civil partner who is credited with pension rights in a scheme by virtue of a pension sharing order.

Pension Input Amount
The amount of contributions paid or increase in value of member's benefits in a registered pension scheme and measured for annual allowance purposes.

Pension Input Period (PIP)
The period over which the pension input amount is measured.

Pension Sharing
If a scheme member's marriage ends in divorce or registered civil partnership is dissolved, a pension sharing order provides the former spouse or civil partner with a share of the scheme member's pension.

Pension Sharing Order
An order or provision following a divorce or the dissolution of a civil partnership which makes provision for the pension rights of a scheme member to be split.

Pension Transfer
A recommendation which involves the transfer out of a scheme, including safeguarded benefits.

Pension Transfer Specialist
An individual authorised by the FCA to provide advice on the transfer of safeguarded benefits. Such an individual must have passed an appropriate examination, for example the CISI's Pension Transfer & Planning Advice (PTPA).

Personal Pension Scheme
A scheme provided by an insurance company or other financial institution to enable members to save for retirement benefits on a money purchase basis.

Phased Retirement
This involves accessing pension benefits in a number of tranches compared to the traditional approach of securing pension benefits at one point in time.

Qualifying Period
The period a scheme member must complete in order to qualify for the award of retirement benefits.

Qualifying Recognised Overseas Pension Scheme (QROPS)
A recognised overseas pension scheme is a qualifying recognised overseas pension scheme if it satisfies certain HMRC requirements. The scheme manager must notify HMRC that the scheme is a recognised overseas pension scheme and provide evidence to HMRC when required. The scheme manager must also sign an undertaking to inform HMRC if the scheme ceases to be a recognised overseas pension scheme and comply with any prescribed information requirements imposed on the scheme manager by HMRC.

Qualifying Service
Service that counts towards the qualifying period that a scheme member needs to complete to be entitled to retirement benefits.

Registered Pension Scheme
A pension scheme is a registered pension scheme at any time when, either through having applied for registration and been registered by the HMRC, or through acquiring registered status by virtue of being an approved pension scheme on 5 April 2006, it is registered under Chapter 2 of Part 4 of the Finance Act 2004.

Relevant Benefit Crystallisation Event (RBCE)
An event at which tax free pension lump sum benefits are paid which is assessed against either the lump allowance or the lump sum & death benefits allowance.

Retirement Annuity Contract (RAC)
An annuity contract between an insurance company or friendly society and a self-employed person or someone not in pensionable employment which was established prior to 1 July 1988.

Retirement Benefits
Pension and (tax-free) lump sum payable subject to completion of a qualifying period and other conditions depending on the type of retirement.

Risk Profiling
A process, typically involving the completion of a questionnaire, whereby firms undertake an assessment of the level of risk that a client is able and willing to take with their investments.

Scheme Administrator
The person or body responsible for the day-to-day management of a scheme, including the maintenance of members' records, the calculation and payment of benefits and the collection of contributions.

Scheme Pension
A pension paid to a dependant of a member of a registered pension scheme following the death of that member, the entitlement to which is an absolute entitlement under the scheme.

Self-Invested Personal Pension (SIPP)
A personal pension aimed at those wishing to benefit from greater flexibility with investments.

Short-Term Annuity
From 6 April 2011 an annuity contract purchased from a member's unsecured pension fund held under a money purchase arrangement that provides that member with an unsecured pension income for a term of no more than five years.

Small Self-Administered Schemes (SSASs)
Company pensions for up to 11 members.

Sponsoring Employer
In relation to an occupational pension scheme, this means the employer, or any of the employers, to or in respect of any or all of whose employees the pension scheme has, or is capable of having, an effect as to provide benefits.

State Earnings-Related Pension Scheme (SERPS)
SERPS was also known as the Additional State Pension. It ran from 6 April 1978 to 5 April 2002, when it was replaced by the State Second Pension.

State Second Pension (S2P)
The second tier of state pension arrangements from 5 April 2002 until 2016.

Tapered Annual Allowance
A tapered annual allowance applies to high earners; those who have an adjusted income greater than £360,000 and whose threshold income is greater than £260,000.

Target Market
In line with the Consumer Duty, the group of people identified by a firm whose needs and objectives are likely to be met by their products.

Transfer Value Comparator (TVC)
A visual illustration of the potential cost of transferring out of a defined benefit pension scheme. A pension transfer specialist is required to provide a TVC as part of the suitability report when providing advice.

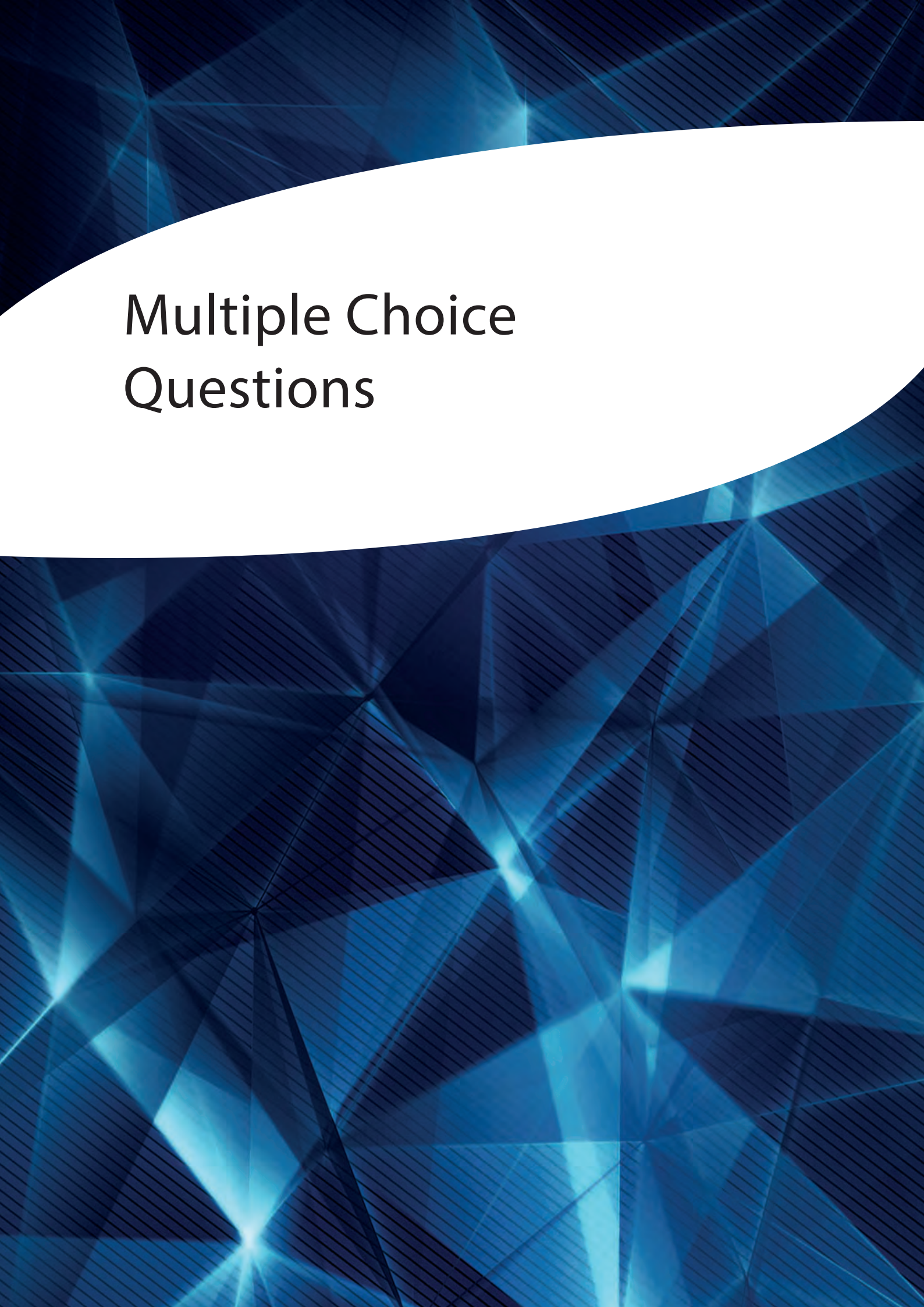
Uncrystallised Funds
Funds held in respect of the member under a money purchase arrangement that have not as yet been used to provide that member with a benefit under the scheme, so have not crystallised.

Uncrystallised Funds Pension Lump Sum (UFPLS)
An authorised lump sum paid on, or after, 6 April 2015 directly from pension savings on reaching age 55 or over. There is no limit on the amount that can be paid subject to having the available lifetime allowance. 25% is paid tax free and the remaining 75% is subject to the member's marginal rate of tax.

Vulnerable Customer
A customer who, due to their personal circumstances and potential impact on their frame of mind, is especially susceptible to harm, particularly when a firm is not acting towards them with appropriate levels of care.

Whole of Life Policy
Whole of life assurance policies will result in the payment of the sum assured on the death of a life assured, whenever that occurs.

Multiple Choice Questions



The following additional questions have been compiled to reflect as closely as possible the standard that you will experience in your examination. Please note, however, they are not the CISI examination questions themselves.

1. What must be analysed to arrive at a client's 'net worth'?

A. House value and any mortgage outstanding
B. Assets and liabilities
C. Income, capital and any tax liability
D. Investable assets and any debts

2. A client with an estate of £700,000, including their own residence, could have a total nil-rate band of which amount before inheritance tax is payable, assuming that they cannot benefit from any transferable nil-rate band and is leaving their estate to qualifying beneficiaries?

A. £175,000
B. £325,000
C. £450,000
D. £500,000

3. When a defined benefit (DB) pension scheme enters the Pension Protection Fund (PPF), members need to be aware that:

A. there is a spouse's pension of 25% of the member's PPF compensation amount
B. those who have not reached the schemes normal retirement age will receive compensation of up to 90% of their pension benefits
C. payments will increase in line with inflation capped at 3% once in payment
D. the monetary payment cap applies to all members pre and post retirement

4. An investor is considering using a buy-to-let property as an alternative way of funding retirement. They need to be aware that:

A. stamp duty is charged at an additional 5% on purchases over £40,000
B. capital gains tax (CGT) may be payable on disposal at the higher rates of 20% and 40%
C. they will be able to claim higher rate income tax relief on the mortgage interest for all of the 20-year term of their mortgage
D. the property will be outside of the estate for inheritance tax (IHT) purposes

5. Which of the following elements is included in a key facts illustration (KFI)?

A. The adviser charge to be deducted from the policy
B. A projection of the final benefits
C. The material risks associated with the product
D. The historic performance of the product

6. **Establishing a client's domicile is important because it may:**

   A. impact on their tax position
   B. affect their ability to take out certain policies
   C. impact on premium loading
   D. affect the underwriting process

7. **Jayden's adviser has been considering a range of protection products for his needs, including a convertible term insurance, a whole of life plan, a decreasing term insurance, and an endowment. Which of the following are unsuitable for Jayden if he wants to accrue a cash-in value?**

   A. A convertible term assurance and a decreasing term assurance
   B. A convertible term assurance and an endowment assurance
   C. A whole of life plan and a convertible term assurance
   D. A whole of life plan and an endowment assurance

8. **For which of the following reasons might a taxpayer's basic rate income tax band be increased?**

   A. Because they have made a personal pension contribution
   B. To take account of an overpayment of income tax
   C. To reduce taxable income by expenditure
   D. To receive tax relief on an investment into an enterprise investment scheme

9. **How many qualifying years will an individual usually need to have accumulated to receive the full rate of new state pension?**

   A. 10 years
   B. 20 years
   C. 30 years
   D. 35 years

10. **A married couple would like to set up a joint life policy where the policy interest will automatically pass to the other in the event of death. Which policy will meet their needs?**

    A. Joint life, second death held on a tenant in common basis
    B. Joint life, first death held on a joint tenant basis
    C. Joint life, first death held on a life tenant basis
    D. Joint life, first death held on a tenant in common basis

11. Which of the following definitions of 'incapacity' is most likely to result in a claim being paid?

A. Suited occupation
B. Any occupation
C. Own occupation
D. Closed occupation

12. What are the key factors that have an impact on the benefits from DB schemes?

A. Years of service, investment returns and pensionable salary
B. Years of service, annuity rates at the time of retirement and inflation
C. Years of service, accrual rate and pensionable salary
D. The scheme's accrual rate, investment returns and inflation

13. If an adviser is establishing a client's capacity for loss, they are most likely assessing their:

A. long-term objectives
B. level of cash needed in an emergency
C. investment time horizon
D. risk profile

14. Luke is retiring in 2025–26, and his pension fund is valued at £1,500,000. He has previously registered for Fixed Protection 2016 at which point he stopped accruing pension benefits. He wishes to take the maximum pension commencement lump sum. He has not previously taken any pension benefits. What will be the maximum lump sum available to him?

A. £250,000
B. £268,275
C. £312,500
D. £375,000

15. Which of the following is a qualifying rule for a life policy to be tax advantageous?

A. Premiums in any one year are no more than one quarter of those paid over the term
B. The policy term is at least 12 months
C. The sum insured is not less than 75% of the premiums payable over the term
D. Premiums can only be paid monthly

16. Which statement accurately describes the relationship between risk and return?

A. The lower the risk taken, the greater the financial return
B. The lower the premium paid, the greater the potential for return
C. The higher the risk taken, the greater the potential for a higher return
D. The premium increases in direct relation to the increase in risk

17. Premiums on qualifying life policies are subject to an annual limit of:

A. £1,500
B. £2,000
C. £3,600
D. £4,000

18. Monthly repayments covered by mortgage payment protection insurance (MPPI) are paid:

A. for a fixed period of time
B. until the policyholder returns to full-time work
C. until the policyholder retires
D. for 36 months only

19. Which of the following is one of the criteria an individual must meet to be eligible for tax relief on their pension contributions?

A. Be a relevant UK individual during the tax year
B. Be domiciled in the UK during the tax year
C. Be over the age of 18 during the tax year
D. Earn over the national insurance primary threshold during the tax year

20. What is the annual management charge on the National Employment Savings Trust (NEST)?

A. 0.3%
B. 0.5%
C. 1.0%
D. 1.5%

21. A business owner is planning to sell their business as part of their retirement plan. In respect of business asset disposal relief (BADR), they should be aware that:

A. they need to have held their shares for at least one year
B. they will qualify providing that they own at least 5% of the shares in the company
C. if available, relief will be at a rate of 7.5%
D. they will qualify, providing that they own at least 10% of the shares in the company

22. Which type of policy will repay a mortgage when a heart attack has been diagnosed?

A. A unit-linked whole of life assurance plan
B. An income protection plan which will provide cover until retirement
C. A mortgage repayment protector plan
D. A level-term assurance with critical illness plan

23. Which of the following is an example of 'unearned income'?

A. Salary
B. Commission
C. Rent
D. Profit

24. A married couple would like to arrange a life policy which will provide the beneficiaries with a lump sum to pay the inheritance tax (IHT) bill due on the total value of their estate. Which of the following plans is the most appropriate to meet their needs?

A. A joint life second death, whole of life insurance policy
B. A joint life first death, whole of life insurance policy
C. Two, single life, gift *inter vivos* policies
D. A joint life second death, gift *inter vivos* policy

25. A client has recently applied for private medical insurance and has been advised that a moratorium will apply. This is likely to indicate that:

A. pre-existing conditions will not be covered
B. underwriting is unlikely to be needed at claim stage
C. premiums are not payable for the first 12 months
D. the client will be unable to claim for any condition for the first 12 months

26. A client is a member of a DB scheme. The fraction used when calculating the benefit (eg, 1/60th or 1/80th) is known as the:

A. rate of accumulation
B. accrual rate
C. commutation rate
D. final salary rate

27. A policy where the life insured and the insured are different people is known as:

A. life of another policy
B. own life policy
C. a policy in trust
D. whole of life policy

28. Two brothers are comparing their respective company pension benefits:

- **Richard is a member of a contributory defined benefit (DB) occupational pension scheme.**
- **Edward is a member of a non-contributory defined contribution (DC) occupational pension scheme.**

In relation to these benefits, it is reasonable to expect that:

A. Richard will be less affected by a salary increase than Edward

B. Edward will bear a greater investment risk than Richard

C. Richard's pension will be taxed more severely than Edward's

D. Edward's pension will have a greater commutable element than Richard's

29. A client has earned income of £107,600. Her personal allowance for the tax year 2025–26 will be:

A. £3,800

B. £4,250

C. £8,770

D. £12,500

30. Which of the following protection policies combines an investment plan with a decreasing term assurance policy?

A. Convertible term assurance

B. With-profits endowment

C. Gift inter vivos policy

D. Low-cost endowment

31. When applying for employment and support allowance, how long is the work capability assessment period?

A. Four weeks

B. Eight weeks

C. Ten weeks

D. Thirteen weeks

32. Which of the following terms refers to adjustments made by life offices to the value of a with-profits policy in the event of a fund switch or policy surrender during periods of poor market performance?

A. Terminal bonus

B. Reversionary bonus

C. Market value reduction

D. Chargeable event

33. Which of the following elements is a key consideration when specifically reviewing the asset allocation factor of a portfolio?

A. Future inflation rates
B. A reduction of the portfolio's risky assets
C. Performance of their assets
D. Change in the value of their assets

34. When arranging a settlement on divorce, which of the following is a disadvantage of a pension attachment order?

A. The ex-spouse can only receive income and cannot receive lump sum benefits
B. The ex-spouse can only receive an income when the scheme member decides to retire
C. Any lump sum payable will be tested against the lump sum allowance of the ex-spouse
D. Income can stop if the scheme member remarries

35. Reversionary bonuses on with-profits policies are usually expressed as a percentage of the:

A. sum insured
B. previous bonuses
C. premiums paid
D. terminal bonus

36. When splitting pension rights in the event of divorce, pension sharing:

A. creates a cash equivalent transfer value
B. allows the scheme member to become the pension credit member
C. allows one party to keep the marital home in lieu of pension rights
D. enables the scheme member to control the retirement date of both parties

37. The benefit from an income protection policy, where the premium is paid by the employer, is paid:

A. net of the appropriate rate of corporation tax
B. net of the individual's normal marginal rate of income tax
C. net of basic rate income tax
D. gross with no further income tax liability

38. A basic rate taxpaying client has an income tax liability of £3,200. How might they be able to reduce this liability?

A. They can deduct any expenses they have incurred from their tax bill
B. Their civil partner can transfer 10% unused personal allowance to them
C. Their own personal allowance will be deducted from the income tax liability
D. They can make a pension contribution, and the gross amount will be deducted from the income tax liability

39. Which of the following life insurance policies is designed to provide beneficiaries with a regular tax-free income from the death of the insured to the expiry of the policy term?

A. Whole of life assurance
B. Level-term insurance
C. Family income benefit
D. Convertible term insurance

40. When advising a client at the decumulation stage, an appropriate strategy for the mitigation of sequencing risk may be:

A. a high-risk approach to maximise returns
B. keeping all the client's assets in a cautious strategy
C. using a horizon planning strategy
D. using the whole fund to purchase an annuity

41. When evaluating recommendations for a client, the financial planner will need to provide information that allows for which of the following?

A. Good communication and justification of the recommendations
B. An understanding of the adviser's regulatory status
C. An appreciation of the correlation between products
D. Trust and confidence in the service provided

42. With an interest in possession trust, who has the right to any income that arises?

A. The settlor
B. The trustees
C. The life tenant
D. The remaindermen

43. What is the key difference between an enduring power of attorney (EPA) and a lasting power of attorney (LPA)?

A. An EPA is set up for property and affairs whereas an LPA can be set up for property, affairs and also personal welfare

B. EPAs cannot come into effect until registered with the Office of the Public Guardian, whereas LPAs do not need to be registered

C. Once the client is incapacitated, they can only apply for an LPA

D. An EPA gives the attorney unlimited powers whereas an LPA limits the powers of the attorney

44. A client has gross earnings of £44,500, including £2,000 of savings income for the 2024–25 tax year. The amount of income tax due on the savings income will be:

A. £200

B. £300

C. £400

D. £600

45. Jesse, age 35 and a higher-rate taxpayer, is considering whether to save for his retirement using individual savings accounts (ISAs) or a registered pension scheme. One advantage of using an ISA over a registered pension scheme is:

A. the tax treatment of the investments held in an ISA is more beneficial

B. he can more readily access the money whenever he wants

C. ISAs have better inheritance tax treatment on death

D. the amount that can be invested in an ISA each year is higher

46. It is possible to carry forward any unused pension annual allowance from the previous:

A. three tax years

B. four tax years

C. five tax years

D. six tax years

47. Which of the following policies incorporates a lower initial monthly premium that increases annually?

A . Low-cost endowment

B. Decreasing term assurance

C. Low-start endowment

D. Unit-linked endowment

48. The annual allowance is tapered for those individuals with adjusted income in a tax year greater than:

A. £100,000
B. £160,000
C. £240,000
D. £260,000

49. A client has earnings of £135,000 in the tax year 2025–26, and also has £10,000 of savings income. The amount of income tax due on the savings income will be:

A. £3,800
B. £4,250
C. £4,275
D. £4,500

50. If the annual allowance needs to be tapered due to someone's earnings, it will be reduced, but only to a minimum of:

A. £3,600
B. £4,000
C. £10,000
D. £30,000

51. Seth reached his state pension age (SPA) in 2017, but as he does not need the money yet, he has decided to defer taking it. Seth should be aware that:

A. his state pension will increase by 1% for every nine weeks of deferral
B. his state pension will increase by 10.4% pa if he defers for 12 months
C. in the event of death during deferral, his spouse can inherit the deferred benefits
D. the extra pension can be paid as a lump sum, providing that the deferral was for 12 months

52. How is a lump sum death benefit, paid from an uncrystallised pension fund taxed where the member died before age 75 and was within their lifetime allowance?

A. Taxed at the special lump sum death benefit charge of 55%
B. Free of tax where funds are paid within two years
C. Free of tax where funds are paid within 12 months
D. Taxed at the special lump sum death benefit charge of 25%

53. Chloe has a small IT company which employs one server engineer with extensive knowledge and experience of each of their client's servers. Which type of protection should Chloe consider in respect of the server engineer?

A. Income protection
B. Key person protection
C. Shareholder protection
D. Partnership protection

54. The UK demographic can be described as having:

A. a decreasing number of people in retirement relative to those of working age
B. decreasing morbidity rates
C. an increasing number of people in retirement relative to those of working age
D. a larger percentage of the population in work to help support those in retirement

55. How much of the initial investment can be withdrawn from a single premium whole of life investment bond on an annual basis without a chargeable event occurring?

A. 5%
B. 4%
C. 3%
D. 1%

56. It is possible to carry forward any unused money purchase annual allowance for:

A. one year
B. three years
C. five years
D. it is not possible to carry it forward

57. The standard rate of bereavement support payment is a lump sum of £3,500 plus how many monthly payments of £100?

A. 4
B. 6
C. 12
D. 18

58. Finley has a personal pension valued at £1 million. In 2016/17 when the lifetime allowance was £1 million, he took a defined benefit scheme valued at £25,000 per year. He did not take tax-free cash as the commutation rate was poor and held no lifetime allowance protection. If he crystallises his personal pension in the tax year 2025–26, what is his position with regards to tax-free cash?

A. He will be entitled to no tax-free cash
B. His tax-free cash will be limited to £143,275
C. His tax-free cash will be limited to £134,137
D. He may be entitled to full tax-free cash of £268,275

59. Anjuli is a higher-rate taxpayer and receives dividends of £10,000 in 2025–26. How much of this will be tax free?

A. £500
B. £1,000
C. £2,000
D. £5,000

60. The key advantage of using a cross option (or double option) agreement in a shareholder protection arrangement is that it:

A. retains business relief for inheritance tax (IHT) purposes
B. is not classed as a gift with reservation
C. qualifies for business asset disposal relief for capital gains tax (CGT) purposes
D. will be treated as a no loss no gain transfer

61. A client has a mortgage of £259,000. In the event that they qualify for full support for mortgage interest (SMI), their mortgage repayments will be covered up to:

A. £200,000 of the capital payment at a rate of 2.21%
B. £200,000 of the capital repayment payment at a rate of 3.16%
C. the interest only portion of £200,000 at a rate of 2.21%
D. the interest only portion of £200,000 at a rate of 3.16%

62. Which of the following could NOT be lost in the event of switching a pension?

A. Protected tax-free cash
B. A guaranteed annuity rate
C. A terminal bonus
A. A protected early retirement age

63. A client's risk tolerance level is set out in which of the following:

A. key features illustration
B. suitability report
C. financial plan
D. key features document

64. To cover the possibility of critical illness, what type of option should be used in a shareholder protection arrangement?

A. Single option
B. Double option
C. Multiple option
D. No option

65. One of the conditions that must be met in order to qualify for bereavement support payment is that the deceased must have died as a result of an accident at work or must have paid National Insurance contributions (NICs) for at least:

A. 4 weeks
B. 8 weeks
C. 12 weeks
D. 25 weeks

66. How many non-occupational pensions can be commuted under the small pots payment rules?

A. Five
B. Four
C. Three
D. Two

67. A small self-administered scheme (SSAS) is defined as being a scheme with less than how many members?

A. 3
B. 10
C. 12
D. 15

68. A client has earnings of £49,500 in the tax year 2025–26. He has made a gross pension contribution of £4,600. His taxable income will be:

A. £32,330
B. £37,000
C. £44,900
D. £49,500

69. When investing in a lifetime ISA (LISA), an investor needs to be aware that:

A. the maximum contribution that will receive a bonus is £5,000 per tax year
B. the government will pay a bonus on all contributions up until age 50
C. the amount that can be held in a LISA is in addition to the current annual ISA limit
D. they cannot access the LISA until age 55, unless it is to be used for a home purchase

70. In a shareholder/partnership protection arrangement, what type of trust should only ever be used?

A. Interest in possession trust
B. Business trust
C. Bare trust
D. Discretionary trust

71. If a policy is held as joint tenants, upon the death of one of them the interest in the policy automatically passes to the:

A. survivor
B. estate
C. personal representatives
D. trustees

72. Paul is taking a small pots payment from a pension already in payment. The tax situation is:

A. a trigger event for the money purchase annual allowance
B. the first 25% of the lump sum will be tax free
C. the lump sum is taxed as pension income
D. the whole lump sum is tax free

73. Sandra is invested in an equity unit trust and she is a higher rate taxpayer. What is the tax position of any dividends that she receives?

A. Those received over the £500 dividend allowance are taxed at 32.5%
B. Those received over the £1,000 dividend allowance are taxed at 32.5%
C. Those received over the £500 dividend allowance are taxed at 33.75%
D. Those received over the £1,000 dividend allowance are taxed at 33.75%

74. If an employee opts out of their employer's auto-enrolment scheme, they must be re-enrolled every:

A. year
B. two years
C. three years
D. five years

75. What is the name of the person(s) who sets up a trust?

A. Settlor
B. Trustees
C. Proposer
D. Life assured

76. What is the maximum financial award that the Financial Ombudsman Service (FOS) can make?

A. £150,000 plus interest and costs
B. £415,000 plus interest
C. £430,000 plus interest and costs
D. £375,000 plus interest

77. Dividends received over the dividend allowance for a basic rate taxpayer are taxed at:

A. 8.75%
B. 10%
C. 13.8%
D. 33.75%

78. Terminal illness benefit will be paid out if such an illness is diagnosed and medical evidence suggests that the policyholder has less than how many months to live?

A. 12 months
B. 6 months
C. 3 months
D. 1 month

79. To justify her recommendations to her client, Rhianna must systematically develop her recommendations in which order?

A. Identify alternatives, evaluate alternatives, identify objectives, select suitable alternatives
B. Identify alternatives, identify objectives, evaluate alternatives, select suitable alternatives
C. Identify objectives, identify alternatives, evaluate alternatives, select suitable alternatives
D. Identify objectives, evaluate alternatives, identify alternatives, select suitable alternatives

80. A service where a firm puts in place an order, but does not give any advice or assess appropriateness, is known as:

A. execution-only
B. guidance
C. simplified advice
D. focused advice

Answers to Multiple Choice Questions

1. **B** **Chapter 1, Section 1.1.2**

Net worth – a statement of the client's assets and liabilities.

2. **A** **Chapter 2, Section 4.2.1**

The residence nil-rate band is £175,000 in 2025–26 plus the basic nil rate band of £325,000. The total nil-rate band is £500,000.

3. **B** **Chapter 3, Section 6.8**

The PPF level of compensation is as follows:

- 100% of pension entitlement for members who have reached the scheme's normal pension age, are in receipt of survivor's benefits or are in receipt of an ill health pension.
- 90% of pension entitlement for members who have not yet reached the scheme's normal pension age.

4. **A** **Chapter 4, Section 1.3.6**

Second properties incur an additional 5% stamp duty land tax. Capital gains tax is payable at 18% and 24%. Income tax relief is now restricted on mortgage interest and at the basic rate of tax. The property will be included in the investor's estate for inheritance tax purposes.

5. **B** **Chapter 5, Section 2.1.4**

Firms must prepare a KFI for each non-PRIIP packaged product they produce. These cover the premium or investment, any guaranteed benefits, (ie, sum assured), a projection of the final benefit based on the FCA-specified assumed growth rate, and the effect of charges and any commission payable to the adviser.

6. **A** **Chapter 1, Section 2.1.2**

If a client is domiciled outside of the UK, this will have an impact on their taxation position.

7. **A** **Chapter 2, Section 4.2**

Term assurance policies do not generally acquire a cash-in value – they are purely used for protection purposes.

8. **A** **Chapter 3, Section 4.1.3**

Gross personal pension contributions expand the basic rate tax band (as do gift aid contributions); in this way the client receives higher rate tax relief.

9. D Chapter 3, Section 8.1.5

The new state pension was introduced in April 2016 and to qualify for the full amount 35 years of National Insurance contributions (NICs) are required, either through contributions or credits – these are known as the qualifying years. Individuals will need ten qualifying years (through contributions or credits) to receive any single tier new state pension.

10. B Chapter 2, Section 4.6

Policies are usually held on a joint tenant basis, which means that on the first death the policy pays out to the survivor.

11. C Chapter 2, Section 5.1

An important factor to consider is the definition used by the insurer to define incapacity. An own occupation policy pays out when the insured person cannot perform their own job.

12. C Chapter 3, Section 2.3

The benefits from defined benefit schemes are a promise to pay a pension based on the:

- member's years of service in the pension scheme
- member's pensionable salary, and
- scheme's accrual rate.

13. D Chapter 1, Section 2.2

The three aspects to risk profiling are:

- appetite for risk
- risk tolerance, and
- capacity for loss.

14. C Chapter 3, Section 4.1.7

The lump sum allowance is the total tax-free cash that can be taken from pension benefits. This is 25% of the previous lifetime allowance; however, it is higher for those with protection. As FP16 gives an allowance of £1,250,000, then his available tax-free cash would be 25% of that figure, ie, £312,500.

15. C Chapter 2, Section 4.8

The qualification rules include the fact that the sum insured must not be less than 75% of the premiums payable over the term.

16. C Chapter 1, Section 2.2

Assessing a client's appetite for risk and matching it to their objectives is a fundamental part of financial planning. Typically, the higher the risk taken, the greater the financial return.

17. C Chapter 2, Section 4.8

The qualification rules include the fact that premiums are subject to an annual limit of £3,600.

18. A Chapter 2, Section 8.6

MPPI is designed to protect monthly repayments on a mortgage if a client's salary drops due to accident, sickness or unemployment. The payments are only made for a fixed period of time: either one or two years, and only after a short deferred period of either 30 or 60 days.

19. A Chapter 3, Section 4.1.1

To be eligible for tax relief an individual must be under 75, be a relevant UK individual and have relevant UK earnings.

20. A Chapter 3, Section 6.14

NEST charges are 0.3% a year plus 1.8% on contributions. There are no limits on contributions other than HMRC limits.

21. B Chapter 4, Section 1.3.2

Business asset disposal relief is available; this charges capital gains tax at a reduced rate of 10% providing that the client is:

- disposing all or part of a business as a sole trader or a partner, including the assets, or
- disposing a business where they owned at least 5% of the shares.

22. D Chapter 1, Section 4.5

The only policy here that will pay a lump sum on diagnosis of a critical illness is a level-term assurance with critical illness.

23. C Chapter 1, Section 4.3

Unearned income includes interest, dividends and income from rent.

24. A Chapter 2, Section 4.1

Inheritance tax (IHT) is paid on the second of the couple to die. The most appropriate plan is, therefore, a joint life second death policy. It must be a whole of life plan so that it pays out whenever death occurs.

25. A Chapter 2, Section 5.1.7

Policies can be underwritten, or they can be accepted without underwriting but subject to a moratorium. This means that pre-existing medical conditions will not be covered – sometimes, this is based on a minimum time period, such as two years. It does mean that the contract can be set up quickly, but it does mean that underwriting is simply delayed until claim stage.

26. B Chapter 3, Section 7.3

The fraction used in defined benefit schemes to build up benefits is known as the accrual rate – this could be 1/60th or 1/80th.

27. A Chapter 2, Section 4.1

The life insured and the insured can be different; these policies are then known as 'life of another' policies.

28. B Chapter 3, Section 3

Members of defined contribution (DC) schemes, or money purchase schemes bear all the investment risk themselves, unlike members of defined benefit schemes.

29. C Chapter 1, Section 4.3

£107,600 – £100,000 = £7,600 / 2 = £3,800. So, £12,570 – £3,800 = £8,770.

30. D Chapter 2, Section 4.3.3

These operate in much the same way as low-cost whole of life plans, with two different policies operating under the structure of one, namely:

- a with-profits endowment, and
- a decreasing term insurance

31. D Chapter 2, Section 3.1.2

There is a work capability assessment period and during this time an amount dependent on age is paid. This period lasts for 13 weeks.

32. C Chapter 2, Section 4.3.2

Once a bonus has been allocated, it cannot be removed. However, most offices reserve the right to apply a market value reduction (MVR) if a policyholder surrenders the policy, or wants to switch out of the with-profits fund. This is more likely to be applied during periods of adverse stock market conditions and poor economic climate.

33. B Chapter 5, Section 3.2

Option B is correct. The financial planner should review whether the portfolio remains suitable for the client based on their age. As the client gets older, the weight in risky assets should be discussed and whether a reduction should be implemented.

34. B Chapter 3, Section 6.4

Pension attachment order does have a number of disadvantages, including:

- it does not provide a clean break between the couple
- the ex-spouse can only receive a retirement income when the other party (whose pension pot it is) decides to retire (which may be delayed)
- if the divorce settlement states there is to be a regular payment of a pension (a periodic payment), the payments will stop on death
- income can stop if the party receiving the pension attachment order remarries
- tax is paid on the pension income at the rate charged to the scheme member regardless of the tax status of the ex-spouse.

35. A Chapter 2, Section 4.3.2

Reversionary bonuses are paid annually and are usually expressed as a percentage of the sum insured.

36. A Chapter 3, Section 6.5

The pension credit is based on the scheme member's cash equivalent transfer value (CETV). The credit is given as a percentage of the CETV, not a fixed sum. The CETV is calculated on the day before the pension sharing order is effective, so it is likely to be higher or lower than the value given at the start of the divorce proceedings. The pension sharing order is effective from the date of the decree absolute.

37. B Chapter 2, Section 5.1.9

Where someone receives income protection payments through their employer, then these are usually taxed as earned income.

38. B Chapter 1, Section 4.3

If one party to a marriage or civil partnership is not using their full personal allowance, 10% may be transferred to their spouse or civil partner as long as they do not pay income tax above the basic rate.

39. C Chapter 2, Section 4.2.6

A family income benefit policy provides a tax-free regular income, as opposed to a lump sum, although some providers also offer the option of a lump sum payment.

40. C Chapter 4, Section 2.4

The range of appropriate strategies for mitigating sequencing risk may include:

- Cash buffers
- Horizon planning
- Dynamic spending
- Taking a blended approach.

41. C Chapter 5, Section 2.1

The financial planner will need to provide information to the client that allows them to easily navigate the various options presented, gain a thorough understanding of the risks and costs associated with these options, appreciate the correlation between products, investments and strategies recommended, and how these will affect the future value of the client's portfolio of assets.

42. C Chapter 2, Section 4.6.3

With an interest in possession trust, the beneficiary has an absolute right to income and is known as the 'life tenant'. They are said to have a 'life interest' in the trust property. Other beneficiaries, known as the 'remaindermen', are entitled to trust capital.

43. **A** **Chapter 2, Section 7.5.1**

An EPA comes into effect as soon as it is made and enables an individual to appoint an attorney to look after their property and financial affairs on their behalf. There are, however, two types of LPA: a property and financial affairs LPA, and a health and welfare LPA.

44. **A** **Chapter 1, Section 4.3**

As a basic-rate taxpayer, £1,000 is tax-free, with the other £1,000 taxed at 20%.

45. **B** **Chapter 3, Section 1.4**

ISAs can be accessed at any time, unlike a pension where funds cannot be accessed until age 55.

46. **A** **Chapter 3, Section 4.1.4**

It is possible to carry forward any annual allowance that has not been used in the previous three tax years to the current tax year if there is sufficient UK taxable earnings in the current year to claim tax relief.

47. **C** **Chapter 2, Section 4.4.4**

A low-start endowment policy is very similar to a low-cost endowment policy, except with a lower initial premium which increases over a number of years, typically for the first five to ten years.

48. **D** **Chapter 3, Section 4.1.4**

For every £2 of adjusted income above £260,000, the annual allowance will be reduced by £1 until the annual allowance is reduced to £10,000.

49. **D** **Chapter 1, Section 4.3**

As an additional-rate taxpayer, the client has no personal savings allowance. The savings income is, therefore, fully taxable at 45%, £10,000 x 45% = £4,500.

50. **C** **Chapter 3, Section 4.1.4**

The maximum reduction to the annual allowance will be £50,000, so anyone with adjusted income in excess of £360,000 will have an annual allowance of £10,000.

This results in an annual allowance of £60,000 for those with an adjusted income of less than £260,000, a reducing annual allowance for those with adjusted incomes between £260,000 and £360,000, and an annual allowance of £10,000 for those with an adjusted income over £360,000.

51. A Chapter 3, Section 9.1

For those who reached state pension age on or after 6 April 2016:

- there is a state pension increase of 1% of pension for every nine weeks of deferral
- 12 months' deferral equates to just under 5.8%
- the deferred amount is paid with the normal state pension payment
- there is no longer the option to take the deferred amount as a lump sum, and
- it is not possible for a spouse or civil partner to inherit deferred benefits (but they can claim up to three months arrears of state pension).

52. B Chapter 4, Section 2.7

A member is required to take financial advice where the cash equivalent transfer value exceeds £30,000.

53. B Chapter 2, Section 2.2.1

Key person cover provides financial protection to a business in the event of a key employee dying or becoming too ill to work.

54. C Chapter 2, Section 1.2.2

It is true to say that, as the population gets older, the number of people of working age to support those of pension age drops.

55. A Chapter 2, Section 4.8.1

An individual investor in a single premium life insurance bond can withdraw 5% of the original investment each year, with no immediate tax liability, for a maximum of 20 years or until 100% of the original investment has been received.

56. D Chapter 3, Section 4.1.4

Any unused money purchase annual allowance (MPAA) in a tax year cannot be carried forward. In the year that the MPAA is triggered, any money purchase contributions made before the trigger date do not count towards the MPAA (but they do count towards the standard annual allowance).

57. D Chapter 2, Section 3.1.6

The first payment is a lump sum followed by up to 18 monthly payments; the amount received depends on circumstances.

58. D Chapter 3, Section 4.1.7

Members who have taken previous benefits prior to 6 April 2024 will normally be assumed to have taken full tax-free cash. However, if they did not and their scheme administrator can provide a transitional tax-free cash certificate confirming the amount they actually took, this will be taken into account when calculating their entitlement.

59. A Chapter 1, Section 4.3

From the tax year 2024–25, the dividend allowance has reduced to £500.

60. A Chapter 2, Section 2.2.2

A cross option (or double option) agreement gives the option to the remaining partners or directors to buy the deceased's interest from the beneficiaries, and giving the beneficiaries the option to sell their inherited shares. You should note that this is an option, not a binding agreement. This is important to keep the inheritance tax business relief on the company shares. If either party exercises their option, the other party must comply.

61. D Chapter 2, Section 3.1.5

If someone qualifies for full SMI, it only covers the interest on the first £200,000 of the mortgage and the standard interest rate used to calculate the benefit is 3.66% regardless of whether the actual mortgage interest rate is higher.

62. D Chapter 4, Section 2.2

A terminal bonus would be paid when a with-profits investment matures or where the fund is sold. All of the others could be lost in the event of a transfer.

63. C Chapter 5, Section 2

The financial plan is a client-specific document which broadly sets out:

1. The client's current financial position.
2. The client's objectives (with an indication of priority).
3. The client's risk tolerance level.
4. Specific considerations (eg, interests in ethical investing).
5. Recommendations for the achievement of objectives.

64. A Chapter 2, Section 2.2.2

If critical illness is used, it is important that a single option agreement is used rather than a double option agreement; this simply gives the ill director/partner the option to sell their shares.

65. D Chapter 2, Section 3.1.6

Bereavement support payment is paid to those:

- whose husband, wife or civil partner died on or after 6 April 2017
- who were under state pension age at the time of death, or
- whose partner either paid NICs for at least 25 weeks, or died because of an accident at work.

66. C Chapter 3, Section 7.20.5

Up to three small non-occupational pensions (such as personal pension plans) can be commuted under small pots payments, but there is no limit on the number of occupational pensions that can be taken under small pots.

67. C Chapter 3, Section 7.17.1

An SSAS is defined as being a scheme with less than 12 members. All members have to be trustees and have an equal say in the running of the SSAS; in reality, most SSASs have a maximum of three to four people.

68. A Chapter 1, Section 4.3

Taxable income is total earnings less the personal allowance minus any other eligible deductions, such as pension contributions, so £49,500 – £12,570 – £4,600 = £32,330.

69. B Chapter 4, Section 1.3.5

With a LISA, any contribution made by the individual will be matched with a 25% top-up from the Government. With the maximum allowance for 2024–25 being £4,000, this means that the maximum contribution by the Government is £1,000. The bonus is given on contributions made until the investor is 50, and the plan is designed to provide a retirement fund or to be used to buy a property. If the cash is withdrawn before the age of 60, other than to use as a deposit for a first home, the bonus plus any interest and growth on that bonus is lost and a withdrawal charge of usually 25% of the amount withdrawn is imposed. This penalty took effect from April 2018.

70. B Chapter 2, Section 2.2.2

The policy must be written under a special type of trust for the other directors/partners. It is important that a business trust is used rather than an ordinary discretionary trust or flexible power of appointment trust. The beneficiaries must be the other business owners to ensure that HM Revenue & Customs (HMRC) views the arrangement as commercial and will not, therefore, suffer adverse inheritance tax consequences.

71. A Chapter 2, Section 4.6.1

If a policy is held as joint tenants, upon the death of one of them, the interest in the policy automatically passes to the survivor.

72. C Chapter 3, Section 7.20.5

Where a pension is already in payment, the lump sum is taxed as pension income.

73. C Chapter 1, Section 4.3

For the 2025–26 tax year, everyone receives a dividend allowance of £500. For a higher-rate taxpayer, dividends over this amount are taxed at 33.75%.

74. C Chapter 3, Section 6.1

The Pensions Act 2008 introduced auto-enrolment which has meant that employers had to automatically enrol their employees into a qualifying workplace pension by 2018. Employees can opt out but must be re-enrolled every three years.

75. **A** **Chapter 2, Section 4.6.3**

The settlor is the person who sets up the trust and transfers the legal ownership of the trust property to the trustees. The trustees look after the trust property for the benefit of the beneficiaries who can be anyone the settlor chooses, but they tend to be a spouse, or a civil partner, children or grandchildren.

76. **C** **Chapter 2, Section 7.7.2**

For complaints referred to the FOS after 1 April 2024, the maximum financial award that it can make is £430,000 plus interest and costs. It can recommend a higher amount, but this figure is not binding on the firm.

77. **A** **Chapter 1, Section 4.3**

The tax rates for dividends in excess of £500 are: for basic rate taxpayers, 8.75%, for higher rate taxpayers, 33.75%, and for additional-rate taxpayers, 39.35%.

78. **A** **Chapter 2, Section 4.6.5**

Terminal illness benefit is an additional benefit which is usually included in life policies. It will pay out if a terminal illness is diagnosed and medical evidence suggests that the policyholder has less than 12 months to live. Once this payment is made, the policy comes to an end; it can be viewed as an accelerated death benefit rather than in addition to the death benefit.

79. **C** **Chapter 5, Section 1.1**

A financial planner should follow a systematic process for developing recommendations, the steps are:

1. Identify objectives.
2. Identify alternative products, investments or strategies to achieve the objective.
3. Evaluate each alternative.
4. Select the most appropriate alternatives based on the evaluation performed at stage three and document justifications.

80. **A** **Chapter 1, Section 3.1.1**

Execution-only is a service consisting of the execution of client orders relating to particular financial instruments at the client's initiative. The firm does not give any advice on investments or assess appropriateness.

Syllabus Learning Map

Syllabus Unit/ Element		Chapter/ Section
Element 1	**Financial Planning**	**Chapter 1**
1.1	**Develop Financial Planning Fundamentals** On completion the candidate should:	
1.1.1	Understand the key purposes of financial planning, and who is involved in the process	1.1
1.1.2	Know the six-step financial planning process as defined by the Financial Planning Standards Board (FPSB): • establish and define the client-planner relationship • collect client data, including personal and financial objectives, needs and priorities • analyse and evaluate the client's financial status • develop and present a financial plan and recommendations • implement the financial planning recommendations • review the client's situation • agree on responsibilities and terms for review of the client's situation • review and re-evaluate the client's situation	1.1
1.1.3	Be able to analyse the key components of a financial plan to include: • client objectives, needs, wants and values • client attitudes to risk • financial planning assumptions • analysis of a client's current financial situation • financial planning strategy • financial planning action plan and recommendations • review financial plan and recommendations • review strategy	1.1
1.2	**Nature of Professional Relationship** On completion, the candidate should:	
1.2.1	Understand the scope of the adviser's authorisation including: • responsibilities • terms of business • nature of the advice process • ethical codes • authorised status and listing on the FCA directory • limitations on the advice the adviser is authorised to give and circumstances in which clients should be referred to a specialist	1.2

Syllabus Unit/ Element		Chapter/ Section
1.2.2	Understand ethics and codes of practice as they relate to financial planning and financial planners: • professional bodies' codes of practice and ethical codes • continuing professional development (CPD) requirements	1.2
1.3	**Collecting Client Information** On completion the candidate should:	
1.3.1	Understand the application of appropriate techniques to collect client information: • elicit all relevant personal and financial information essential to the financial planning process • assessing a client's risk tolerance	2
1.3.2	Understand how to meet know your customer (KYC) requirements	2
1.3.3	Be able to evaluate affordability and other suitability considerations; environmental, social and corporate governance (ESG) and religious preferences	2
1.3.4	Be able to analyse gaps, errors or inconsistencies in client information, subjective factors or indicators, including: • use of appropriate skills when questioning information or assumptions • gaining agreement on any reinterpretation	2
1.4	**Streamlined Advice** On completion the candidate should:	
1.4.1	Know what is meant by 'streamlined advice': • simplified advice • focused advice	3.1
1.4.2	Understand the key considerations in verifying client information supplied by a third-party	3.1, 3.2
1.5	**Analyse the Client's Financial Status** On completion the candidate should:	
1.5.1	Be able to identify the client's circumstances, including: • assets and liabilities • any foreseeable changes to their circumstances	4
1.5.2	Be able to calculate net worth: • during lifetime • on death • on specific events such as illness, disability or retirement	4
1.5.3	Be able to calculate net spendable income or income shortfall	4

Syllabus Unit/ Element		Chapter/ Section
1.5.4	Be able to calculate cash flow at key life stages including: • current • at retirement • on ill health • on death	4
1.6	**Establishing Priorities** On completion the candidate should:	
1.6.1	Be able to evaluate and respond to the main drivers underpinning the client's financial needs and objectives and aspirations, by prioritising them in collaboration with the client: • identify differing client needs, realistic financial objectives and associated timescales • prioritise present and future needs • agree investment objectives, growth, income, time horizons • net disposable income	5
1.7	**Analyse Existing Arrangements** On completion the candidate should:	
1.7.1	Be able to analyse gaps in a client's current financial provision and how the client's financial provision could be improved according to agreed priorities: • immediate liquidity • ongoing income and expenditure • protection • retirement provision • attitude to risk and growth/investment return assumptions • ethical values/environmental, social and corporate governance (ESG) requirements	6
1.7.2	Be able to evaluate the performance and suitability of the client's existing investments taking into account the client's current financial provision	6
1.7.3	Be able to evaluate the performance and suitability of the client's existing investments taking into account the client's objectives	6
1.7.4	Be able to evaluate the performance and suitability of the client's existing investments taking into account the client's: • risk appetite • risk required • capacity for loss	6
1.7.5	Be able to evaluate the performance and suitability of the client's existing investments taking into account the client's current and future tax status	6

Syllabus Unit/ Element		Chapter/ Section
Element 2	**Financial Protection**	**Chapter 2**
2.1	**Market Trends** On completion the candidate should:	
2.1.1	Be able to analyse consumer attitudes and behaviours to protection needs planning	1.1
2.1.2	Know the factors relevant to consumer access to advice and/or insurance cover	1.1
2.1.3	Be able to interpret trends in: • health and morbidity • longevity and mortality • employment	1.1
2.1.4	Be able to interpret the implications for product design and development	1.1
2.1.5	Be able to understand the intended target market defined by the product provider	
2.2	**Protection Planning** On completion the candidate should:	
2.2.1	Be able to evaluate personal, family income and capital protection needs relevant to health, incapacity and accident cover	2
2.2.2	Be able to evaluate personal, family income and capital protection needs relevant to income, mortgage and other debt	2
2.2.3	Be able to evaluate personal, family income and capital protection needs relevant to death and asset protection	2
2.2.4	Be able to evaluate the role of insurance in mitigating personal financial risk	2
2.2.5	Know the areas of business protection needs – small and medium-sized enterprises (SMEs)	2
2.3	**Sources of Financial Protection** On completion the candidate should:	
2.3.1	Understand the role of state benefits/local authority funded solutions: • state pension and pension credit • housing, rebates, mortgage repayment and Council Tax benefits • incapacity, disability, sickness and maternity benefits • state benefits on death • social care provision • universal credit and other tax credits	3.1
2.3.2	Be able to analyse the limitations of state benefits and state/local authority-funded solutions for financial protection	3.1
2.3.3	Be able to analyse how state and other welfare benefits can be incorporated into a financial plan	3.1

Syllabus Unit/ Element		Chapter/ Section
2.4	**Life Assurance Policies** On completion, the candidate should:	
2.4.1	Understand the range of products available for financial protection needs: • types of policies, comparative costs, benefits and advantages • cost and premium calculation factors • legal requirements, ownership, uses and relevance of trusts • underwriting and claims • terminal illness benefit and other additional benefits • assignments, surrenders, paid-up policies, claims	4
2.4.2	Be able to analyse the structure and application of life assurance, and employment-based policies	4
2.4.3	Be able to interpret the taxation treatment of life assurance policies including: • qualifying and non-qualifying life insurance policies, offshore life insurance policies • taxation of life funds (onshore and offshore) • capital gains tax (CGT) and life assurance policies • inheritance tax (IHT) and life assurance policies	4
2.5	**Income Protection** On completion, the candidate should:	
2.5.1	Understand the following: • definitions, exclusions, premium calculation factors • underwriting and claims • taxation treatment • special treatment of business income protection	5
2.5.2	Be able to evaluate: • the types of policies available • features and uses • comparative costs • advantages and disadvantages	5
2.5.3	Know the range, structure and application of income protection insurance options relating to group policies	5
2.6	**Critical Illness Protection** On completion, the candidate should:	
2.6.1	Be able to evaluate: • types of policies available • structure • comparative costs • advantages and disadvantages	6
2.6.2	Know market developments for critical illness insurance	6

Syllabus Unit/ Element		Chapter/ Section
2.6.3	Know the following: • definitions, conditions, exclusions • terms and amount of cover – factors, assessment • premium calculation factors • underwriting and claims: issues and processes • claims	6
2.6.4	Be able to evaluate the taxation treatment of critical illness protection	6
2.6.5	Understand the interaction between critical illness insurance and life assurance	6
2.6.6	Be able to evaluate the range, structure and application of critical illness protection in relation to group policies	6
2.7	**Long-Term Care Planning** On completion, the candidate should:	
2.7.1	Know the range, structure and application of long-term care insurance to meet financial protection needs including: • political environment, social care policy, national factors	7
2.7.2	Know the main product types and features	7
2.7.3	Be able to evaluate long-term care protection taking into account cost, resources and appropriate options	7
2.7.4	Understand factors relating to: • immediate needs provision • long-term care planning process	7
2.7.5	Know legal considerations relating to vulnerable clients: • The Mental Capacity Act 2005 definition of capacity • lasting power of attorney and the different types • deputy of the Court of Protection	7
2.7.6	Understand the regulatory considerations that apply to long-term care insurance: • Financial Conduct Authority's (FCA's) 'packaged product'/retail investment products regime • roles of Financial Ombudsman Service (FOS) and Financial Services Compensation Scheme (FSCS) • provision of pre- and post-sales information • claims handling rules	7
2.8	**Insurance-Based Protection** On completion, the candidate should:	
2.8.1	Be able to analyse the main features of personal accident, sickness insurance and unemployment insurance	8
2.8.2	Be able to analyse the main features of private medical insurance, hospital plans and dental insurance	8
2.8.3	Be able to analyse the main features of payment protection insurance – mortgage, credit	8

Syllabus Unit/ Element		Chapter/ Section
2.9	**Selecting Appropriate Protection Solutions** On completion, the candidate should:	
2.9.1	Be able to evaluate the relevant factors for individuals and business clients when it comes to planning their financial protection requirements: • priorities, risk and choices • existing arrangements • consequences of inadequate protection	10
2.9.2	Be able to calculate the current and future capital and income needs in real terms for: • family and personal protection • SME business protection needs – business loans, key person, partnership and shareholder protection	10
2.9.3	Be able to evaluate the relevant factors in selecting appropriate solutions taking account of: • similar types of products • client needs • identifying and matching suitable product solutions to needs • combinations of products • current and future affordability • property purchase	10
2.9.4	Be able to evaluate appropriate solutions in relation to: • cohabitation • marriage • civil partnership • birth of a child • separation and divorce	10.6
2.9.5	Be able to evaluate appropriate solutions in relation to: • work • going overseas • retirement	10.6
2.9.6	Be able to analyse estate planning and its application in the financial planning process: • the basics of wills and will planning • the events that invalidate wills • laws of intestacy • importance of regular reviews • use of lasting powers of attorney	4, 7, 9

Syllabus Unit/ Element		Chapter/ Section

Element 3	Retirement Planning	Chapter 3
3.1	**Pension Provision in Context** On completion, the candidate should:	
3.1.1	Understand the social and macroeconomic factors influencing the development of pension policy: • role of government, policy direction, challenges • demographic trends, longevity and ageing population • registered pensions, main types of pension provision • incentives, disincentives and attitudes to saving, and economic factors and influences	1
3.2	**The Main Types and Methods of Pension Provision** On completion, the candidate should:	
3.2.1	Understand State Pension benefits	2
3.2.2	Understand defined benefit (DB) schemes	2.3
3.2.3	Understand defined contribution (DC) schemes	3
3.3	**Pension Scheme Taxation** On completion, the candidate should:	
3.3.1	Be able to interpret how the HMRC tax regime applies to pensions planning: • taxation of contributions to pension schemes, and relevant tax relief • taxation of retirement and death benefits from pension schemes • annual allowances, lifetime allowance, transitional protections, money purchase annual allowance and other limitations on tax relief • tax treatment of non-registered pension in outline	4
3.4	**The Regulatory Landscape** On completion, the candidate should:	
3.4.1	Know the role of the Financial Conduct Authority (FCA) with respect to pensions regulation	5
3.4.2	Know the role of the Pensions Regulator with respect to pensions regulation	5
3.4.3	Know the role and powers of relevant Ombudsman services	5
3.4.4	Know the training and competence requirements for a pension transfer specialist	5.4

Syllabus Unit/ Element		Chapter/ Section
3.5	**Applying Pensions Law and Regulation** On completion, the candidate should:	
3.5.1	Be able to interpret aspects of pensions law and regulation relevant to retirement planning: • employment law relevant to pensions • pensions, divorce and breakdown of family relationships • bankruptcy law and pension assets • The Pensions Regulator's compliance requirements • Financial Conduct Authority rules • pension protection schemes	6
3.5.2	Understand the relevant aspects of pensions law and oversight: • trust-based and contract-based DC pensions • roles and duties of trustees, administrators and professional advisers	6
3.5.3	Understand auto-enrolment schemes, employer duties, contributions, workers' opt-in/opt-out, payroll and default issues	6
3.5.4	Be able to identify and avoid pension scams	6.15
3.5.5	Understand misselling issues	6.15
3.6	**Defined Benefit (DB) and Defined Contribution (DC) Schemes** On completion, the candidate should:	
3.6.1	Understand the key characteristics and application of DB pension schemes: • structure, characteristics, attributes and benefits • main types, variations and hybrids • rules and operation of DB schemes • funding methods and issues • membership eligibility criteria and top-up options • factors to consider and benefits of leaving, transfers from DB to DC and DC to DB, early and normal retirement • roles of trustees, and other parties, and scheme reporting • the impact of employer covenants • benefits on ill-health or death • private and public sector schemes	7

Syllabus Unit/ Element		Chapter/ Section
3.6.2	Be able to analyse the options available from DB pension schemes regarding retirement planning for individuals: • factors to consider and benefits on leaving; early, normal and late retirement • benefits on ill-health and death • switching issues and considerations • public sector schemes • retirement benefits • leaving benefits • ill-health benefits • pension commencement lump sum (PCLS) and interaction with pension income • death benefits before and after crystallisation	7
3.6.3	Understand the main DC pension accumulation options: • main types of DC schemes, their features costs and benefits • the main differences between contract-based and trust-based DC arrangements • employer and employee and other individual contributions – the main methods and issues • switching between DC pension arrangements, safeguarded benefits and pensions consolidation • death and sickness benefits • investment choices and restrictions	7
3.6.4	Understand the main DC decumulation rules and options in relation to retirement planning for individual customers: • flexi-access drawdown • uncrystallised funds pension lump sum (UFPLS) • annuity purchase • drawing the whole pension fund as cash • small pots/trivial commutation rules	7
3.7	**State Retirement Benefits** On completion, the candidate should:	
3.7.1	Understand the structure, relevance and application of the state schemes in relation to an individual's pension planning: • basic state retirement benefits; structures, state retirement ages (SRA), levels of benefit, link to national insurance records and SRA • Pension Credit framework • other relevant state benefit entitlements	8

Syllabus Unit/ Element		Chapter/ Section
3.8	**Taking a Retirement Income** On completion, the candidate should:	
3.8.1	Be able to evaluate the different ways of taking benefits: • reasons for taking or deferring state retirement benefits • considerations when taking income and/or lump sum benefits from a DB scheme • considerations when taking income and/or lump sum benefits from a DC scheme	9
3.8.2	Be able to analyse the advantages and disadvantages of different types of annuities	9
3.8.3	Be able to assess the eligibility for an enhanced or impaired annuity	9

Element 4	Retirement Solutions	Chapter 4
4.1	**Financial Planning and Advice for Retirement** On completion, the candidate should:	
4.1.1	Understand the importance of the need to align planning and advice with a client's essential needs and realistic financial aspirations and ensure recommendations are suitable	1
4.1.2	Be able to analyse retirement aims and objectives taking account of the following factors: • availability and prioritisation of savings and investments • limits on tax relieved contributions and their impact on accumulation methods • attitude and expectations as regards retirement and working in later life • assumptions and impact • conflict with other objectives • timescales and risk, including inflation and longevity risk	1
4.1.3	Be able to evaluate existing policies and alternative solutions available for pension income and long-term care requirements: • alternative sources of capital including non-pension investment assets • equity release products • proceeds from sale of a business or property • inheritance • buy to let, individual savings accounts (ISAs), unitised securities, alternative investments • Shariah-compliant solutions	1

Syllabus Unit/ Element		Chapter/ Section
4.1.4	Be able to evaluate the merits, limitations and suitability of investments available to meet stated objectives taking account of: • when and how retirement may occur • phased retirement • projected levels of investment risk and return • investment strategy and fund selection criteria • impact of fees and charges • products and wrappers, critical yield and optimal crystallisation dates • other sources of non-pension income	1
4.2	**Post Retirement Investment Strategies** On completion, the candidate should:	
4.2.1	Understand the reasons and ways to access pension funds	2
4.2.2	Be able to evaluate phased retirement options, benefits and risks	2
4.2.3	Be able to analyse the options and factors to consider with regard to developing a post-retirement investment strategy for: • financial provision for care in later life • timing of decisions and implementation • provision for dependants • sequencing risk • sustainability of income in retirement	2

Element 5	Financial Planning Recommendations	Chapter 5
5.1	**Develop Financial Planning Recommendations** On completion, the candidate should:	
5.1.1	Understand how to develop recommendations; explain and justify outline recommendations to meet/address client needs, goals, objectives, and other issues or problems where appropriate; draft initial recommendations for a suitable financial plan	1
5.1.2	Be able to evaluate the advantages and disadvantages of different strategies	1
5.1.3	Be able to evaluate whether all recommendations are suited to the client's situation and financial requirements, including: • appropriateness and relevance of proposed solutions, products and, where applicable, providers • alternative courses of action where no suitable product is available • whether they match the client's agreed risk/reward trade off • affordability	1

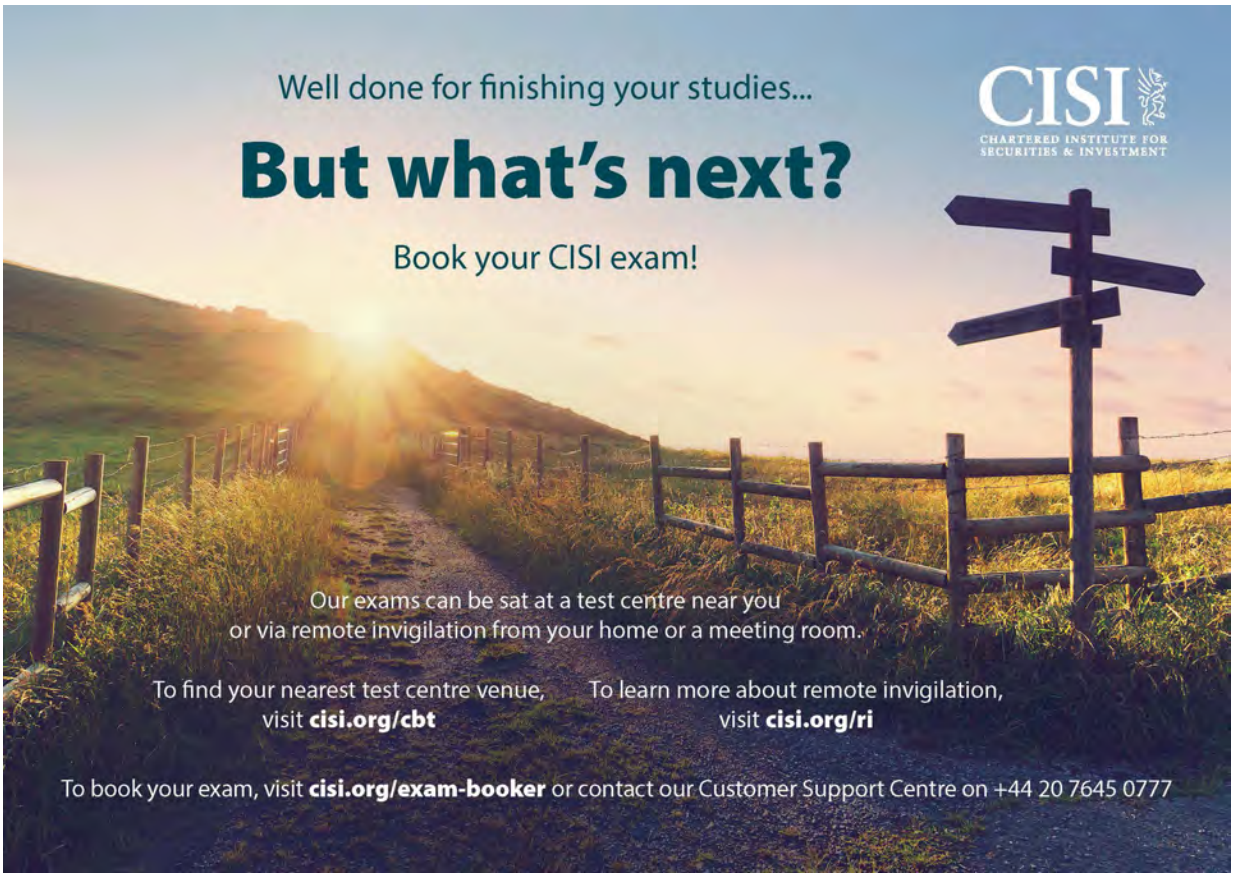
Syllabus Unit/ Element		Chapter/ Section
5.1.4	Be able to analyse the requirement to appropriately balance the interrelationship between protection, saving and investment, and other objectives such as liquidity and retirement	1
5.2	**Implement Financial Planning Recommendations** On completion, the candidate should:	
5.2.1	Be able to evaluate how the plan and/or recommendations meet the client's specific needs, in a manner that the client can understand, including: • explanation of appropriate financial protection products to the client and how they meet client needs • appropriateness and suitability • characteristics, correlation, advantages and disadvantages of different products • comparison of the different options available • implications of the different recommendations on other parts of the financial plan • advantages and disadvantages of the proposed recommendations including costs • how the recommendations take account of future needs • how the recommendations will be handled, including the need for monitoring and review	2
5.3	**Review the Client's Situation** On completion, the candidate should:	
5.3.1	Understand how to conduct financial planning reviews and review meetings, including: • purpose and frequency of reviews • process of reviewing a financial plan • initiating a review meeting and gathering the data required • what is discussed at a review meeting	3
5.3.2	Be able to analyse actions that may be required after the review, including: • reassessing and rebalancing asset allocation • review of existing financial solutions	3

Examination Specification

Each examination paper is constructed from a specification that determines the weightings that will be given to each element. The specification is given below.

It is important to note that the numbers quoted may vary slightly from examination to examination as there is some flexibility to ensure that each examination has a consistent level of difficulty. However, the number of questions tested in each element and/or case study should not change by more than two.

Element Number	Element	Questions
1	Financial Planning	17
2	Financial Protection	19
3	Retirement Planning	24
4	Retirement Solutions	12
5	Financial Planning Recommendations	8
Total		**80**



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Consider examples of conflicts of interest, tools, policies and procedures, enforcement action, and good practice.



Data Science
Digitisation of business operations has accelerated the speed of data capture. Harness the value of your data.



Diversity and Inclusion
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Gain an overview of insider dealing, market abuse, money laundering, terrorist finance and financial sanctions.



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Gain an overview of the financial planning process, key terms and the regulatory framework that governs it.



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Aim to take ethical and sustainable investment principles a step further through intentional investment.



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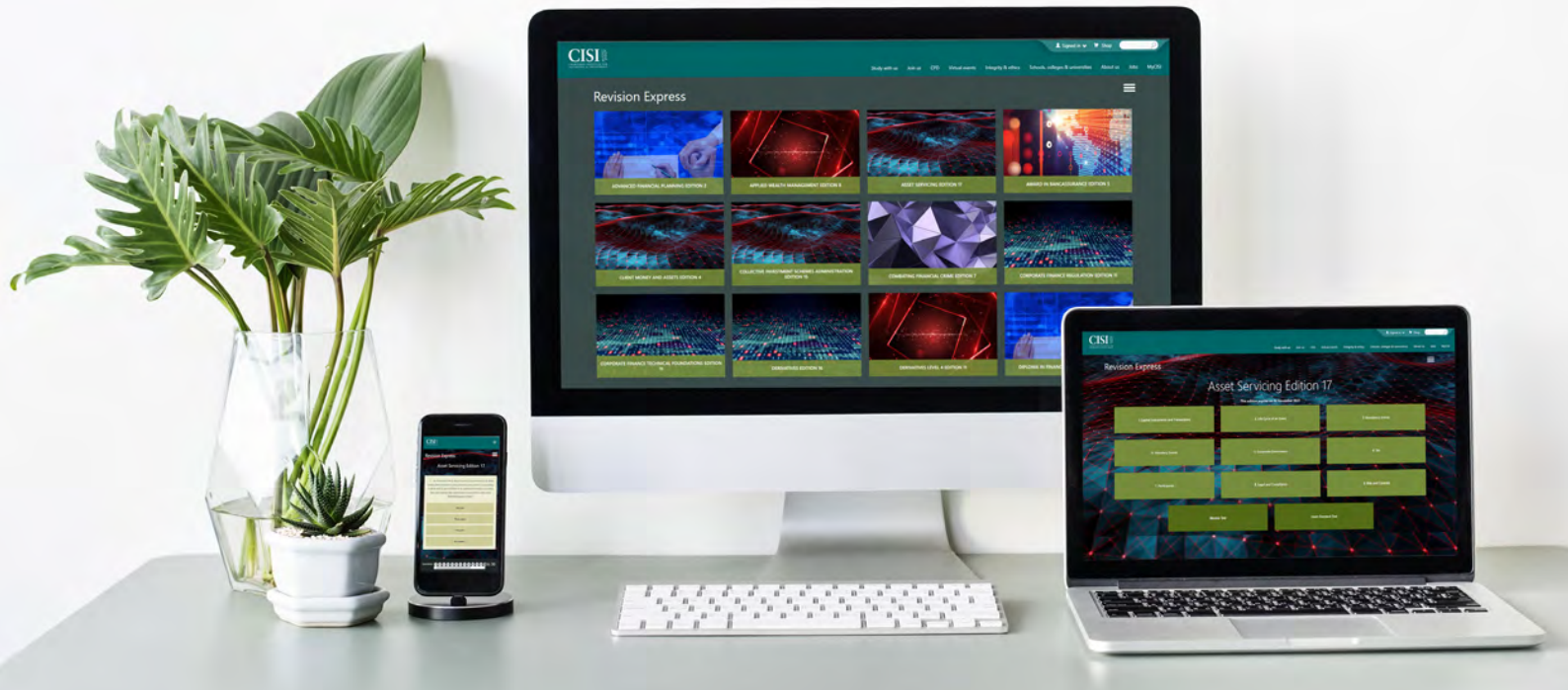

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