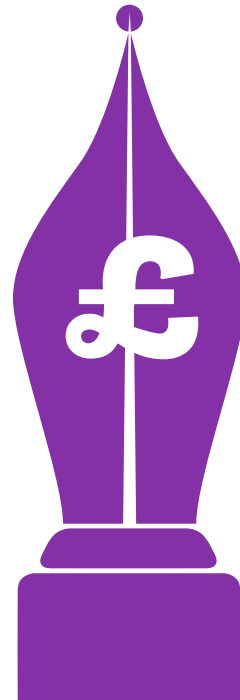




HOW TO MAKE SURE THE RIGHT PERSON GETS YOUR PENSION WHEN YOU'RE GONE



Good with your Money Guide 6

1. INTRODUCTION

When someone who is a member of a pension scheme dies, the people they leave behind may be entitled to valuable benefits. This can be in the form of a regular pension, a lump sum or both. But who gets those benefits?

At the time when many of these schemes were set up, most people got married and stayed married to the same person for all of their life.

But these days we are much more likely to get divorced, re-marry or choose to cohabit. For instance data from the Office for National Statistics (ONS) shows that in 2016 there were 3.2m cohabiting couples in the UK. This compares to approximately 1.5m in 1996.

This means it can be far less obvious *who* should get any benefits from our pension scheme when we are gone. In particular, if we have not told our pension scheme or pension provider about our wishes and about our current family circumstances, there is a risk that the person who benefits is not the person we would have wanted to benefit. This includes schemes we may no longer be contributing to but which will still provide us with benefits when we retire.

Just looking at those in the 55-64 age group, we estimate that over three quarters of a million people are now in a second or subsequent relationship where their wishes as to who should benefit from their pension may have changed over time.

The purpose of this short guide is to explain the different sorts of benefits available from pension schemes when someone dies, and to highlight the importance of making sure that those schemes have an up-to-date picture of who you want to benefit after you are gone.

2. THE DIFFERENT SORTS OF PENSION SCHEMES AND THE DIFFERENT TYPES OF BENEFITS

The benefits available when you die depend on two things – the sort of pension arrangement you were a member of and whether you had started to receive benefits from the pension or not.

a) Defined Benefit (DB) pensions – salary-related ‘pensions with a promise’

In the past, most people who worked in the public sector or for a large company could join a ‘final salary’ or ‘salary-related’ pension scheme. Under this sort of pension arrangement there is a pension promise (a ‘defined benefit’) that you will get a certain amount depending on how long you contributed to the scheme and how much you earned.

- If you die after you have started to receive a DB pension, the law generally requires schemes to pay a regular pension to a surviving spouse. This will often be a set percentage of your regular pension, often 50%.

- If you die before you reach pension age but after you have left the company, the scheme may pay a lump sum benefit to a nominated recipient. This may simply be a refund of the contributions that you made. In more generous schemes there may also be a regular pension available.
- If you die while you are still an active member of the scheme, there may be an extremely valuable ‘death-in-service’ benefit payable, often based on a multiple of your annual earnings. This is, in effect, a form of life insurance.

In all of these cases, it is important that the benefits from the scheme are paid out in line with your wishes.

b) Defined Contribution (DC) pensions – a pot of money with your name on

These days, most new pension arrangements are ‘Defined Contribution’ schemes where you build up a pot of money that can be used to support you in retirement. Again, the nature of the support available

to your heirs when you are gone depends on where you are in your retirement journey when you die.

- If you have taken your pot of money and turned it into an income for life (or an ‘annuity’) then whether there is anything for your heirs depends on the sort of annuity that you have bought. If you bought a ‘joint life’ annuity then when the first person named on the policy dies, a payment will continue to be made to the second person. If you bought a ‘single life’ annuity then in general the payments stop on your death, though some policies have a guarantee period where payments continue for a minimum period of time (e.g. for the first five years after retirement).
- If you still have money in your DC pension pot which you have not turned into an income for life or if it is being held in an ‘income drawdown’ account post-retirement, this money is available to your heirs and you will need to specify who you want to benefit. Whereas with a DB pension an ongoing ‘survivor’s pension’ will only usually be paid to a spouse or partner (or a dependent child), with a DC

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pension you can nominate other people – such as grown-up children – to be the beneficiaries of your pension pot.

If your DC pension was organised by an employer, especially a larger private sector employer, it may be set up as a Trust. This means that there are trustees whose job is to look after the members' interests and make decisions about the pension arrangements. But DC pensions can also be based on a contract between the member and a pension provider such as an insurance company. Examples include the 'group personal pensions' into which millions of workers have been automatically enrolled in recent years, as well as individual personal pension arrangements. In this case it is the pension provider who oversees what happens to your pension.

Problems can arise if you name a beneficiary (e.g. a surviving spouse) who on your death asks that the proceeds be paid to say the children instead. If the children weren't dependent any more, they couldn't be offered the death benefits in the form of drawdown –

it would have to be a lump sum or a pension. This is because drawdown can only be offered to dependants or those named by you. The way round this is to not only name your spouse but also the children. However you're only naming the children so that they can be offered the full range of death benefits if this situation arises.

c) Taxation

There are some important issues to be aware of when it comes to how these benefits are taxed. In general, pension assets are not included in a person's estate for inheritance tax purposes. When it comes to income tax the rules are:

- If you die before the age of 75 and leave money in a DC pension pot or in an 'income drawdown' arrangement, your heirs do not have to pay income tax on the money they withdraw;

- If you die aged 75 or over, the beneficiaries have to pay tax at their highest marginal income tax rate on any withdrawals;
- If you receive death benefits from a defined benefit scheme they are taxable.

If the deceased has pensions and death-in-service benefits worth more than the lifetime allowance (£1m in 2017/18 rising to £1.03m in 2018/19) then there may be some tax to pay on this. It is well worth your heirs taking professional financial advice in such a situation. You should also check with your pension scheme whether you would be affected in this way.

3. WHO DECIDES WHO GETS YOUR MONEY AND HOW DO THEY DECIDE?

a) Different types of recipient

What happens on death depends on what type of scheme you are part of and the scheme rules. In the past, pension benefits generally had to be paid to dependants, but there is now more flexibility over who can inherit a pot of money that has had some money withdrawn from it but still has a balance remaining. The different categories are:

- A dependant is someone who is financially dependent on the person who died. This could include spouses, civil partners or a child who is still dependent on the member, for example because they are still in full-time education;
- A nominee is someone chosen to receive a benefit, 'nominated' by the scheme member or the scheme, who need not necessarily be a dependant;
- A successor is someone named by a dependant or nominee to inherit the pot when they die.

Benefits also don't have to be paid out to just one person, a number of people could benefit.

The rules about who can get your pension benefits depend on whether they are in the form of a regular pension income or a lump sum. Broadly speaking, regular pension benefits can only be paid to a dependant, nominee or successor of a member who has died, but (with limited exceptions, such as 'trivial' lump sums – where all your pension benefits not including State Benefits are worth less than £30,000) there are no restrictions on who can receive lump sum benefits.

b) Discretion versus Direction?

Schemes will have different rules and processes they go through to determine how pension death benefits are allocated. However, when joining a scheme you will be asked to fill in an "expression of wishes" form which allows you to say who you would like to receive your death benefits when you die.

Scheme members currently have two options open to them when working out how death benefits can be allocated. One option leaves the money potentially liable to inheritance tax while the other does not.

The administrator can be asked to use their discretion when deciding who can receive the lump sum death benefit. This means the administrator should take the member's wishes into account but is not bound by them. So for instance on the member's death the administrator may find the member was divorced from the person named in their expression of wishes form and they had gone on to have children with someone else. In such a case the administrator may choose not to follow the wishes stated in the form. In such cases the lump sum death benefit would be free of inheritance tax.

However, if the administrator was given a direction by the member to pay the benefits to certain people then the administrator must comply with the request even if the member's circumstances had changed. In such a case the value of death benefits would be included in the deceased's estate for inheritance tax purposes.

3. WHO DECIDES WHO GETS YOUR MONEY AND HOW DO THEY DECIDE?

c) Different types of pension arrangements

Next, we consider the different types of pension arrangements and who decides how your pension benefits are distributed after your death.

- **Trust-based schemes**

If you are a member of a trust-based scheme then there will be a board of trustees who have been granted the discretion to decide who will receive the benefits from your pension. They have a duty to do their best to find out who should receive any death benefits. This will involve making enquiries about your personal circumstances at the time of your death so they can establish who your dependants, nominees and successors are likely to be.

All these schemes will have an ‘expression of wishes’ form and it is vitally important that you keep this up to date if you are a member of such a scheme, especially if your family circumstances have changed. Trustees are not legally bound to follow the instructions, but it will obviously have a big influence on their decision as to who should benefit. They will also look at any wills that may have been drafted as well as talking to employers, family and friends about your personal circumstances in the run up to death. Using this information, they can then make an informed decision as to how the benefit should be allocated.

To update these forms then call your previous pension providers or employers to request the necessary forms. If you are having trouble locating an old employer then contact The Pensions Tracing Service (See Section 4).

- **Contract-based schemes**

There are different ways of dealing with this issue if you are part of a contract-based scheme. A contract based scheme is one provided by an insurance company or other pension provider. Your employer may contribute to the scheme but it is essentially a contract between the member and the provider.

In such schemes there are no trustees with discretion to decide who gets the benefits (apart from certain lump sum death-in-service benefits) though administrators will make decisions on how benefits are distributed. In the documents you receive when starting the pension you might be encouraged to set up what is called a ‘discretionary trust’ and nominate people as potential beneficiaries to it. On death, the provider then has the power to distribute benefits under the trust. Alternatively, other providers will simply ask members to specify how they want the provider to distribute their benefits when they join the scheme.

3. WHO DECIDES WHO GETS YOUR MONEY AND HOW DO THEY DECIDE?

Summary

It is clearly important that expression of wishes forms are kept up to date for all pensions you may have. It can be easy to lose contact with people and if trustees and scheme administrators are unable to establish your most up-to date personal circumstances then there is a very real chance that an ex-spouse or partner could receive the benefits while your current partner knows nothing about it or your children may be missing out on valuable financial support.

If you have kept these forms up to date then all should be well – but what if you haven't? You may have been happily married or in a long-term relationship when you filled out the form initially but in the intervening years you could have separated, divorced or even re-married. You may even have had children. The result is that your priorities are likely to have changed over that time and you may not want the same people to have your pension after you die as you did in the past.

The situation is exacerbated by the fact that we are more likely to change jobs and according to the Department for Work and Pensions the average person can have 11 different jobs over the course of working life. This could translate to 11 different pension pots. The chances are that even if you have updated your expression of wishes form for your current pension, have you done it for all of them?

4. WHAT CAN MARRIED COUPLES GET AND DOES IT DIFFER FROM CIVIL PARTNERS AND COHABITEES?

How death benefits are distributed is very different for couples depending on whether they are married, in a civil partnership or cohabiting:

a) Married couples

If one partner dies and no other dependants can be found then the likelihood is that the death benefits would automatically be awarded to the surviving spouse even if there is no expression of wishes form.

b) Civil partnership/Same sex marriages

The situation for those in civil partnerships/ same sex relationships is more complicated than for married couples, though things have been made clearer following the outcome of a long-running legal case.

Walker v. Innospec

The Supreme Court delivered its judgement in the Walker v. Innospec case in July 2017. Mr. Walker worked for Innospec from 1980 and retired in 2003. He had lived with his partner since September 1993. They entered into a civil partnership in January 2006 and went on to get married.

Mr Walker found that when calculating the survivor's pension payable to a same sex spouse or civil partner, the Innospec scheme (like many other defined benefit schemes), only takes into account pensionable service from 5 December 2005 – the date the Civil Partnerships Act 2004 came into force. Because Mr Walker left service

before this date, his husband's pension would only have reflected certain contracted-out rights and would have been much smaller than if he had been married to a woman.

However, the Supreme Court ruled that the December 2005 exemption under UK law is incompatible with EU legislation. This means that on Mr Walker's death his husband will be entitled to a spouse's pension based on his full period of pensionable service.

The judgement means that many DB pension schemes will need to amend their scheme rules and revisit any current survivor's pensions in payment.

4. WHAT CAN MARRIED COUPLES GET AND DOES IT DIFFER FROM CIVIL PARTNERS AND COHABITEES?

c) Cohabiting couples

While cohabiting couples may live together for many years and even raise a family together it is important to realise that they have no special legal status and no automatic entitlement to the death benefits of a partner. As a result it is extremely important for cohabiting couples to keep their expression of wishes forms up to date.

The issue was at the centre of a recent high profile legal case.

The Brewster case

In February 2017 Denise Brewster won a long running legal battle to receive payments from her late partner's pension with a Northern Ireland local government pension scheme. They had lived together for ten years and had become engaged shortly before her partner died.

Had they been married, Ms. Brewster would have been automatically entitled to a survivor's pension. However, as they were unmarried she was only eligible for survivor's allowances *if* she had been nominated on a form. In this case, the form had not been completed.

It took Ms Brewster eight years before the Supreme Court finally ruled that the use of the form represented "unlawful discrimination" given the fact that it would not have needed to be filled in if the couple were married. While pension schemes are likely to have some rules to help ensure that people are genuinely cohabiting, they are now likely to review whether operating systems of this sort are discriminatory.

5. WHAT CAN YOU DO?

- Keeping your documentation up to date will help trustees and pension providers to work out what your personal circumstances are so they can make an informed decision when allocating death benefits. Updating your will is extremely important as is reviewing any expression of wishes forms for any pensions you have held during your career.
- If you need help in finding any previous pensions then it is worth contacting The Pensions Tracing Service to see if they can help.
<https://www.gov.uk/find-pension-contact-details>
- If you think you should have received a death benefit following the loss of a loved one but did not then you should contact The Pensions Advisory Service (TPAS) to get more information
<https://www.pensionsadvisoryservice.org.uk/>
This service is staffed by pension specialists who will tell you if they think you have a valid case. You should also contact the scheme in question as it will have an internal dispute resolution process that you can go through. If you do not get the

outcome you hoped for and your TPAS adviser believes you have a case then the service will help you present your case to The Pensions Ombudsman
<https://www.pensions-ombudsman.org.uk/>
The decision of the Ombudsman is final and can be enforced in the courts. Its decision can only be changed by appealing to the appropriate court on a point of law.

APPENDIX: INHERITING STATE PENSIONS

As an individual, you have no say in who gets any benefit from your state pension after your death, but it can be helpful to understand how the rules work.

The first thing to be aware of is that state pension inheritance is based exclusively on marriage or civil partnership – members of cohabiting couples have no rights to inherit any state pension in respect of a deceased partner.

Whether you can inherit any state pension and how much you can get depends on whether you reached state pension age before or after 6th April 2016.

a) 'Old' state pension system – reached pension age before 6th April 2016

The old state pension system had a number of provisions which allowed a widow or widower to receive an improved state pension following the death of a spouse. The rules are complex but the key points are:

– For the basic state pension, if the surviving spouse is not getting a full basic pension they may be able to make a claim on the basis of their late spouse's National Insurance record. A common situation would be a widow on an incomplete basic state pension who is able to get a full state pension as a widow based on her late husband's contribution record

– For the state earnings related pension scheme (SERPS), generally 50% of any SERPS pension is inheritable by a surviving spouse. However, for older SERPS recipients a higher percentage can be passed on in line with the following table:

| Man's date of birth | Woman's date of birth | Maximum % of SERPS and State Pension top up you can inherit |
|----------------------------------|----------------------------------|---|
| 5 October 1937 or before | 5 October 1942 or before | 100% |
| 6 October 1937 to 5 October 1939 | 6 October 1942 to 5 October 1944 | 90% |
| 6 October 1939 to 5 October 1941 | 6 October 1944 to 5 October 1946 | 80% |
| 6 October 1941 to 5 October 1943 | 6 October 1946 to 5 October 1948 | 70% |
| 6 October 1943 to 5 October 1945 | 6 October 1948 to 6 July 1950 | 60% |
| 6 October 1945 and after | 6 July 1950 and after | 50% |

Source: <https://www.gov.uk/additional-state-pension/inheriting>

APPENDIX: INHERITING STATE PENSIONS

It should be noted however that there is a complex interaction between inherited SERPS and periods when the late spouse was 'contracted out' of an occupational pension scheme, and this can sometimes reduce or eliminate the value of the inheritance.

b) 'New' state pension system – reached pension age on or after 6th April 2016

The new state pension system is predominantly based around individuals rather than couples. Individuals are assessed at pension age on the basis of their own record of National Insurance contributions rather than that of a spouse or former spouse.

However, there is a transitional feature of the new state pension system known as the 'protected payment' which can be passed on in part to a widow or widower.

Under the new state pension system, someone with 35 years of full rate National Insurance Contributions is entitled to the new 'flat rate' pension. But those who had already built up a larger pension entitlement than this

under the old system (basic pension plus SERPS) can receive a pension larger than the flat rate amount. The excess of the actual pension paid over the standard flat rate is called a 'protected payment'. Half of this protected payment can be inherited by a surviving spouse.

To give an example, suppose that the flat rate state pension was (in round numbers) £160 per week, but someone was actually being paid £180 per week because they had built up a large state pension entitlement before the new system was introduced. The 'protected payment' in this case is £20 per week (the excess of £180 over £160). If the recipient were to die, his or her spouse would be entitled to £10 per week – half of the protected payment.

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