How freezing the Lifetime Allowance affects redress

Spring 2021

In the March 2021 Budget, the Chancellor has frozen the Lifetime Allowance (LTA) at its current level of £1,073,100 for 5 years until 2025/2026. This is a further step in grinding down the value of high earners' retirement pensions. The LTA caps the maximum pension value that the investor can take before incurring the LTA tax charge. The link of the LTA to the growth of the CPI since 2018 is now halted. Before that the LTA was reduced in stages from its highest level of £1.8 million in 2010/11 to £1 million in 2016/17.

So called Protection has been available whenever the LTA has reduced. For instance after the LTA was reduced from £1.25 million to £1 million in April 2016 investors could apply to HMRC for Fixed Protection 2016 meaning that they could 'lock in' the LTA of at least £1.25 million. There was unfortunately for most investors an important condition attached to this Fixed Protection. Starting 6 April 2016 they could make no further contributions, either personally or by their employer, to an existing personal pension plan. (The position for defined benefits is more complicated than this.)

When advising high earners on pension transfers from defined benefits to personal pensions the adviser must take account of the impact of the LTA on the personal pension 'pot' when the investor comes to take retirement benefits. A defined pension is valued at 20 times the annual pension for LTA purposes. However, in recent years the value placed on defined benefit pensions when they are transferred to personal pension could be 30 (or more) times the annual pension. This means that transferring out could push the investor over the LTA. Or at least this could be the effect sooner than would have occurred under defined benefits.

For example, a defined pension of £50,000 pa has a value for LTA of 20 x £50,000 = £1 million, currently below the LTA. However the transfer value offered might be as much as £1.5 million putting the value after transfer well over the current LTA of £1,073,100. The investor would then be liable for a substantial LTA tax charge on taking the benefits – and, because of the way that the LTA charge is calculated, potentially also at age 75.

If after the transfer it is found to be unsuitable, perhaps because the risks associated with holding a personal pension were not fully explained or taken into account, the adviser firm may be obliged to compensate not only the loss of value by comparison with the value of defined pension (based on FCA guidance FG17/9) but also compensate for any LTA tax charge, or its increase.

Because the LTA charge applies to an investor's overall pension provision, it is necessary when advising on transfer out, or when calculating compensation for unsuitable advice, to be mindful of all the investor's pensions. This adds complexity to the situation, particularly given the range of circumstances which can trigger assessment against the LTA.

The freezing of the LTA through to 2025/26 together with the uncertainty of what happens to the LTA after that (will the linking to CPI be re-established or will a further freeze be imposed?), means that more and more investors will be at risk of reaching their lifetime limit. This will have implications both for the number of defined benefit transfers that can proceed and for redress calculations, with the intricacies of allowing for the LTA impact in transfer loss assessment affecting more and more cases. This has implications both for the advice process, where there may be increased risk in recommending a transfer, and for redress calculations where the intricacies of making allowance for LTA charges will need appropriate attention.

At OAC our Redress Team is dedicated to the assessment and calculation of redress for transfers from defined benefits to personal pensions, where the advice to transfer have been shown to be unsuitable.

For more information

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