AVCs were overlooked on retirement – what can we do now?

INSIGHT ARIES Pensions Legislation Systems

Even under the best-run schemes, sometimes mistakes can happen. Occasionally, when a member retires and takes their benefits under an occupational pension scheme, a money purchase AVC fund might be overlooked and is then not spotted until some time after the main benefits have come into payment.

The question that arises is '*how can these AVCs be settled now?*'. Whilst each case is different and the best solution for one case might not be appropriate for another, we have set out below some of the options for settling overlooked AVCs that could be considered.

Importantly, a scheme can only settle benefits in accordance with the terms of the scheme rules, so for any proposed solution, the scheme rules may need to be checked to ensure that they permit that type of payment proposed. For example, some scheme rules may prohibit the payment of more than one PCLS.

Uncrystallised funds pension lump sum (UFPLS)

It may be possible to pay out the AVC funds as an UFPLS, provided that:

- If the member is under 75, they have sufficient Lifetime Allowance available
- If the member is over 75, they have some Lifetime Allowance still available
- The member does not have Primary or enhanced protection including protected lump sum rights of over £375,000, or a Lifetime Allowance protection factor where the available proportion of their lump sum allowance is less than the value of the AVC fund.

Remember that, where a member takes an UFPLS, they become subject to the Money Purchase Annual Allowance, so this solution might not be appropriate in all cases.

Flexi-access drawdown

It could be possible for the member to designate the AVCs as being available for flexi-access drawdown. Up to 25% of the value of the AVC fund could be paid as a PCLS, subject to the member having sufficient Lifetime Allowance available.

The member would become subject to the Money Purchase Annual Allowance at the point that any payment is made from the funds designated as available for flexi-access drawdown so, as for an UFPLS, this solution might not be appropriate in all cases.

New lifetime annuity

The AVCs could be used to purchase a new lifetime annuity for the member, with up to 25% of the AVC fund value payable as a PCLS, subject to the member having sufficient Lifetime Allowance available.

Note that if the scheme rules prohibit partial retirement, the lifetime annuity would have to be backdated to the member's original retirement date.

Whether this solution is viable will depend on the size of the AVC fund as most annuity providers have a minimum purchase price that they will accept.

Top up an existing lifetime annuity

Where there is an existing lifetime annuity in payment, the AVCs could be used to top up this annuity, again with up to 25% of the AVC fund value payable as a PCLS, subject to the member having sufficient Lifetime Allowance available.

As before, whether this solution is viable will depend on the size of the AVC fund as most annuity providers have a minimum top up price that they will accept and in some cases this is far larger than the minimum they will accept by way of new business.

New scheme pension

The AVCs could be used to set up a new scheme pension with up to 25% of the AVC fund payable as a PCLS subject to the usual conditions. As before, if the scheme rules prohibit partial retirement, the pension would have to be backdated to the member's original retirement date. Also, the member would have to be given the option of a lifetime annuity as an alternative to a scheme pension.

Importantly, the provision of a new scheme pension from money purchase benefits will mean that the member becomes subject to the Money Purchase Annual Allowance if, at the time the member becomes entitled to the scheme pension, there are fewer than eleven other individuals currently entitled to payment of a scheme pension or a dependant's scheme pension under the scheme.

Transfer out

The member will have a statutory right to transfer out the AVCs, unless they have already used any money purchase benefits to secure a lifetime annuity or scheme pension, or have designated any funds as available for the payment of a drawdown pension.

Even where no statutory right exists, the scheme rules may permit non-statutory transfers.

What else should I be aware of?

Where the AVCs are used to provide benefits for the member, this will usually represent a BCE, so a new Lifetime Allowance test will be required and the member notified of the percentage of their Lifetime Allowance that has been used up.

If the overlooked AVCs were not spotted until after the member had reached age 75, an automatic BCE (a BCE 5B) will have occurred when the member reached that age. This would mean that the scheme will have to perform a 'retrospective' Lifetime Allowance test which will cause particular problems if it is found that the member actually exceeded their Lifetime Allowance, as the scheme should have accounted to HMRC for the Lifetime Allowance charge that arose at that time.

A particular problem will arise if, on their original retirement, the member was entitled to a protected cash sum (i.e. scheme specific protection of a lump sum of over 25% of the member's uncrystallised rights). This is because one of the conditions that must be met for a protected cash sum to be paid is that, broadly, the member must have become entitled to all of their rights under the scheme at the same time and, where any AVCs have been overlooked, this condition will not have been met. This would mean that any part of the member's protected cash sum paid that was in excess of the usual Pension Commencement Lump Sum limit, based on the value of the benefits that did originally crystallise, will have been an unauthorised payment.
A similar problem arises if the member took all of the original benefits as a stand-alone cash sum. In this case, however, the entire stand-alone lump sum would have been unauthorised, because the lump sum paid would not have represented all of the member's uncrystallised rights under the scheme.

Note, however, that where the member's protected cash sum was paid in connection with the individual becoming entitled to at least two of the following benefits:

- a scheme pension under a defined benefits arrangement,
- a scheme pension under a money purchase arrangement,
- a lifetime annuity,

the requirement for entitlement to all the pensions to occur on the same day does not apply.

In such cases, the individual must become entitled to all their pensions within six months of first becoming entitled to any one of them. If the overlooked AVCs are spotted soon enough after the earlier benefits crystallised, this six month time limit may give scope for the AVCs to crystallise without affecting the member's right to the protected cash sum.

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