



Pension Planning For Gay Men & Lesbians

(Updated May 2004)

Why Bother?

Pensions are not very exciting but they are important – and not just as you get older. They are important to younger people as well. First, because they may provide benefits for your partner (and children) on your death. Second, because the earlier you start to build up pension rights, the more control you will have over the timing of your retirement. Third, because for most people it is no longer realistic to rely on the state pension - not only is the basic state pension falling in value, but it gives no option for early retirement - and the state retirement age is progressively being increased to 65 for both men and women from 2010 to 2020. The latest talk is of increasing state retirement age to 70.

Most people now accept the need for additional private pension provision.

Complications

For historical reasons, pensions are extremely complicated. There are different tax regimes, a vast number of regulations and a lot of options to consider. Expert advice is normally needed, preferably from an independent financial adviser (an "IFA"). A number of insurance companies are still unsympathetic to gay men and an adviser with experience in the lesbian and gay market can be a great help.

Types of Pension Scheme

If you are trying to establish your rights under a pension scheme, the first thing to decide is what type of scheme it is. In addition to the State pensions, there are currently four main types of pension scheme:

- occupational pension schemes, which are run by companies and public bodies;
- personal pensions, which belong to individuals - either employed or self-employed;
- group personal pensions, which are personal pensions arranged by employers – the employer normally pays a contribution but the policy belongs to the individual;
- stakeholder pensions, intended for employees who do not have access to a company pension scheme.

Apart from these, there are many special types of pension scheme, for example, retirement annuities for the self-employed and pension schemes for directors and executives. These all require expert advice.

To complicate matters further, the Government has made major changes to the state pension.

A State Second Pension (known as S2P) has replaced the State Earnings-related Pension Scheme (SERPS). This will provide better state benefits for low earners.

The State Pension

The main elements of the state pension are as follows:

1. The basic state pension. This is currently £4139.20 a year for a single person and £6617.00 a year for a married couple – but only if there is a full contribution record, usually around 40 years. The pension is reduced if contributions have been paid for a shorter period.
2. The State Earnings-related Pension Scheme (SERPS). SERPS provides a complicated salary-related benefit – broadly 20% of earnings, within set limits. It does not apply to individuals who have contracted-out and paid contributions to a private scheme instead. SERPS will be phased out and replaced by the State Second Pension when it comes into full force.
3. The State Second Pension (S2P), introduced in April 2002. Together with the basic state pension, S2P will provide a pension of 40% of average earnings up to £11,600 a year, 10% of earnings between £11,600 and £26,600 a year, and 20% of earnings over £26,600 a year, subject to an upper limit. Carers and the disabled will receive credits in S2P as if they were earning £11,600 a year.

It will also be possible to contract-out of S2P if a private pension is available. The government's hope is that eventually all employees earning over £11,600 a year will have private pensions, and that S2P will then become a flat-rate benefit.

In the meantime, the state provides a minimum income guarantee. This is a means-tested benefit which provides a minimum level of income in retirement by topping up the basic state pension to around 20% of average earnings. Any private pension will need to provide a pension of at least this amount to be worthwhile.

Occupational Pension Schemes

Occupational pension schemes come in two main types:

1. private sector pension schemes;
2. public sector pension schemes.

Private sector pension schemes are normally set up by companies. The contributions are paid over to trustees, who are responsible for the administration of the scheme and the payment of benefits. The company normally appoints the trustees and lays down the rules to be followed. Many schemes now have some member-nominated trustees but in most cases, it is the company which effectively controls the type and level of benefits provided.

Public sector pension schemes are normally set up by statute. The management of the schemes is laid down in regulations issued by the Government. The type and level of benefits from these schemes are effectively controlled by the Treasury. One of the big advantages of occupational pension schemes is that the employer meets the cost of running the scheme. Occupational pension schemes can take much of the responsibility and worry away from individual pension planning. However, members usually have little option over the type of benefits provided. Many schemes still discriminate against unmarried members in the provision of survivors' pensions.

Personal Pensions and Group Personal Pensions

Personal pensions are usually set up with insurance companies or investment managers, often by financial advisers working for insurance brokers (who take commissions) or pension consultants (who normally charge fees). Personal pensions are usually set up under trust, with the insurance company or investment manager as trustee.

Group personal pension schemes work in the same way as personal pensions, but often have some financial advantages. For example, the company will usually make a contribution and may be able to secure better terms from the insurance company or investment manager.

Personal pensions are more flexible than occupational pension schemes and can usually be arranged to include benefits for partners. One of the disadvantages of personal pensions is that the costs of running the scheme normally have to be met by the member. It can be very expensive to set up a personal pension – a lot of advice and paperwork is involved. A lot of these costs are taken from the first years' contributions, so that personal pensions often have very low values in the early years. Because of this, a personal pension should be seen as a long-term commitment. It is very important to be satisfied with the insurance company and the terms offered from the start because it can be very difficult and expensive to change. This is one of the reasons why good advice is needed, so that the personal pension fits your personal circumstances.

Stakeholder Pensions

Stakeholder pensions were introduced in April 2001. They offer low-cost pension benefits on a voluntary basis to employees who are not members of another scheme. From October 2001, all companies with more than 5 employees were required to offer access to a stakeholder pension and operate payroll deductions.

The maximum contribution by employees is £3,600 a year, or the personal pension limit if higher. The employer is not required to contribute.

Stakeholder plans are set up either under trust or by an authorised scheme manager. The maximum charge is 1% of the value of the fund each year.

Basis of Pension Schemes

Pension schemes are normally run in one of two ways:

1. a final salary (or "defined benefit") basis - where the pension is a proportion of final salary at retirement, for example 50% after 40 years' membership.
2. a money purchase (or "defined contribution") basis - where the pension is the amount which can be provided by the fund built up at retirement, either as income from the fund or by purchase of an annuity.

Most of the larger occupational pension schemes provide final salary benefits. Most smaller schemes and all personal pensions and stakeholder pensions operate on a money purchase basis. Final salary benefits are generally preferable, because of the certainty they give. Money purchase benefits will depend on investment performance and annuity rates at retirement, and are much less predictable. They may give greater flexibility, but individual schemes and individual needs are all different and this is an area where expert financial advice is required.

Most pension schemes also give members the option to take part of their retirement benefits in cash. The cash option is tax free under current legislation.

Areas of Concern for Lesbians and Gay Men

Most of the detailed issues relating to pensions apply equally to everyone. There are some specific issues of concern to lesbians and gay men, arising from discrimination in the rules governing the payment of death benefits. This occurs in two areas

1. lump sum death benefits;
2. pensions for unmarried partners

Lump Sum Benefits on Death before Retirement

Almost all company pension schemes provide a lump sum benefit in the event of a member's death in service before retirement. This is also often included as part of a personal pension. Personal pensions and stakeholder pensions will normally provide for the accumulated fund to be paid out in addition.

Most pension schemes allow members to nominate a beneficiary to whom they would like the lump sum benefit to be paid. The rules of pension schemes can be drafted widely so that the benefit can be paid not only to relatives and dependants but to any individual, charity, society or club nominated by the member. Although the benefit is normally paid at the trustees' discretion, it is most unlikely in practice that they would pay the benefit elsewhere.

The important point is to make sure that a nomination form (sometimes called an "expression of wishes" form) has been completed. Otherwise, trustees may decline to pay a lump sum benefit to an unmarried partner. If there is any uncertainty over the beneficiary, trustees will often pay a benefit to the estate. It may then become subject to inheritance tax. There is also likely to be a delay in payment.

Lump Sum Benefits on Death in Retirement

After retirement on pension, most schemes also provide a lump sum in the event of a pensioner's death within five years of retirement (known as a "five year guarantee"). Most annuities arising from personal pensions also include this provision. Personal pensions which provide for income to be drawn during retirement, instead of an annuity, normally provide for the whole fund to be paid out, although it may be liable to tax.

Survivors' Pensions on Death in Service before Retirement

Most final salary pension schemes provide a survivor's pension in the event of a member's death in service before retirement. Some money purchase schemes provide a survivors' pension on death before retirement, or provide a higher level of lump sum benefit to be used to buy a survivors' pension.

Survivors' pensions are normally paid automatically to the legal spouse. They can be paid to other individuals at the trustees' discretion but only if they were "financially inter-dependent" (see below). As a result, in most occupational pension schemes, unmarried partners cannot automatically expect to receive the same pension benefits as their married colleagues.

Personal pensions and stakeholder pensions do not usually provide a survivor's pension on death before retirement – the value of the fund is paid out instead.

Survivors' Pensions on Death in Retirement

Most final salary pension schemes provide a survivor's pension in the event of a member's death in retirement. As explained above, survivors' pensions are normally paid automatically to the legal spouse but are paid to other individuals at the trustees' discretion and only if they can show that they were "financially interdependent".

Money purchase pension schemes and personal pensions usually leave the member to choose whether to include a survivor's pension in the annuity bought at retirement. A number of insurance companies will provide pensions for unmarried partners from a personal pension. You can usually shop around until you find an insurance company that will do this.

What Does "Financially Interdependent" Mean?

Pension schemes have major tax advantages. In return the Inland Revenue lays down rules that they must follow. These rules are drawn up by the Pension Schemes Office of the Inland Revenue in Nottingham. The Inland Revenue Practice Notes set out the requirements which pension schemes need to comply with in order to gain Inland Revenue approval and so qualify for tax relief. In practice, these regulations apply to virtually all pension schemes in the private sector.

Following a change of Inland Revenue practice in 1996, tax-approved pension schemes can provide pensions in circumstances where two partners in a relationship are "financially interdependent" on each other. An example is where the partner needs a second income to maintain a standard of living which had depended on joint income prior to the member's death.

Decisions on whether unmarried partners were financially interdependent are a matter for pension scheme trustees. The Inland Revenue will not challenge trustees' judgement in this respect provided that they have acted in accordance with the rules of the scheme.

The Current Situation

The payment of partners' pension is entirely voluntary for employers. Many private sector pension schemes include this provision. Most public sector pension schemes do not.

A recent survey of the biggest company pension schemes shows that most of them make some reference to pensions for 'dependants' at the trustees' discretion. About half of these refer to unmarried partners. Nearly a quarter of the schemes surveyed made specific reference to same-sex partners. This trend is also confirmed by the Annual Survey of the National Association of Pension Funds.

A number of private sector schemes are clearly trying to provide equal benefits for unmarried partners, although same-sex partners are still disadvantaged because of the Inland Revenue rules. Public sector schemes show a much lower level of provision.

The Political View

During the Committee Stage of the Pensions Act on 6 th June 1995, it was proposed that the equal treatment rules relating to pension schemes should be amended to cover two specific areas of discrimination:

- any provision of a pension scheme which is less favourable to a person of a particular sexual orientation than it is to a person of the same sex but with a different sexual orientation, should automatically be treated as being modified so that it is not less favourable;
- where a single person lives as husband or wife with a person of the opposite sex or in a corresponding relationship with a person of the same sex the benefits should be the same as those for persons who are married.

None of the Members of Parliament who spoke challenged the principle on which the call for equal treatment was based - that unmarried couples should in principle be entitled to equal treatment under the law with regard to their pension provision. All the objections that were raised related to practicalities and the appropriateness of achieving equality by means of the legislation at that time.

The amendment was withdrawn on the basis that the matter would be considered as part of a later review.

What is Being Done Now

A number of bodies, including Stonewall and the TUC, are continuing to press for changes in the rules so that unmarried partners will have the same access to pension rights as married partners.

What You Should Do About Your Pension Rights

If you are a member of a company pension scheme:

- Check to see what the pension scheme booklet says about the payment of benefits on your death (or ask for a copy if you cannot find it, or if your copy is more than a couple of years old).
- Check if you can nominate a beneficiary for the lump sum death benefit.
- If so, check to make sure that your nomination is up to date – or ask for a form so that you can make a new nomination.
- Check to see if the scheme provides a pension for a spouse or dependant.
- If a pension is provided for a dependant, does this include an unmarried partner and a same-sex partner?
- If the booklet is not clear, ask the pension manager.
- Check to see if you can nominate a beneficiary for the dependant's pension.
- If your pension scheme does not provide a pension for an unmarried same-sex partner, ask if the rules can be changed.

If you are a member of a personal pension, a group personal pension or a stakeholder pension:

- Check to see what the policy says about the payment of benefits on your death (or ask the insurance company or your financial adviser if it is not clear).
- Check if you can nominate a beneficiary for any lump sum death benefit.
- If so, check to make sure that your nomination is up to date – or ask for a form so that you can update your nomination.
- When the time comes to convert the fund into a pension, ask if there is an option to include a pension for an unmarried partner.

If you have retired:

- Check the statements you were given when you retired to see what they say about lump sum benefits and pensions for dependants on your death.
- If you have any doubts, contact the pension manager or insurance company and ask them to clarify the position.

In practice, once you have retired, there is normally very little you can do to alter the terms of your benefits.

How To Get Help

This summary is intended to give only a brief outline of the main issues involved in pension planning. Since everyone's situation is different, most people will need detailed information and advice. This is available from a number of sources. If you are already a member of a pension scheme, the booklet should give you details of contacts. Otherwise, your pensions manager, insurance company or financial adviser should be able to help or give you the names of bodies you can go to for further information.

Pensions can be very difficult to understand. Members have a right to information about their benefits, but it can sometimes take a long time to get an answer, particularly if a question needs to be referred back to trustees. Many pension schemes have not yet had to deal with the issue of pensions for unmarried same-sex partners and the trustees may need to refer back to the company for approval.

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To see whether we can help with your pension planning, contact us now:

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