



RISK BULLETIN

Financial Adviser Edition

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Collegiate's risk bulletins are designed to provide our policyholders with bite-sized bulletins on recent claims or trends that we are seeing as the UK's leading specialist in Professional Indemnity Insurance.



The difference between 'discretion' and 'direction' for pension administrators.

This bulletin focuses on the topic of 'discretion' and 'direction' for pension administrators and trustees after a string of recent decisions from the Financial Ombudsman Service on the subject. The FOS have made it clear that any advisory firm dealing with pensions, retirement and tax planning must be fully aware of the differing implications of each for pension trustees and make these very clear to their clients.

In most cases, pension scheme administrators are given a discretion as to the paying of death benefits. This means that such benefits will not normally be included in the value of the estate and are not, therefore, subject to IHT. The discretion given to the scheme administrators is often accompanied by a 'letter of wishes' or 'nomination form' which informs them who the policyholder would like benefits paid to. It is important to note that this is only an expression of the policyholder's wishes and is not in any way binding on the scheme administrators.





IN A RECENT FOS CASE, THE SERVICE MADE THEIR POSITION ON THIS AREA CLEAR:

“From the evidence available, it appears as though the firm were fully aware of the implications of the different ways of nominating a beneficiary yet didn’t at any point explain these to the client. There was no follow up at any stage from the firm about the beneficiary nomination despite this having major implications for the payment of death benefits under her policy.”

“The firm had a duty to advise the client on how to arrange a discretionary nomination and why.”

“Despite the client’s objectives, the firm can’t demonstrate they discussed the beneficiary nomination with the client in any detail”

In the case in question, the client contacted the pension provider directly and made a mistake about what type of instructions she was giving, however it was held that the firm did not provide her with enough general guidance on the direction/discretion distinction in the advice process.

Points to consider



- Always provide some guidance on the difference between ‘discretion’ and ‘direction’ to clients
- Consider reviewing whether a client’s pensions have been set up under discretion or direction, including who has been selected as potential beneficiaries, as part of any annual/periodic review with the client. It would also be sensible to document that this has been undertaken as part of the review
- Whether ‘discretion’ or ‘direction’ is chosen can impact IHT
- Discretion is a ‘one time’ decision and a client cannot later change their mind and opt for a ‘direction’ to their scheme administrators
- There are a number of limited circumstances when providing discretion will lead to funds being treated as within the estate for IHT purposes, including when someone is knowingly in poor health and lives for less than two years
- Not all types of pension allow for ‘discretion’ to be given to the pension administrators. Equally, only certain pensions allow for ‘direction’
- Giving ‘direction’ can be very beneficial if the client is in serious ill health and dies within two years of the transfer, as the client retains their spousal exemption, which would be lost under ‘discretion’

NOTE

- This guidance is based on the current law/rules and the position may change in 2027 with the government’s proposed changes to how IHT applies to pensions
- Nothing in this note is intended to be legal advice.