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COUNTDOWN TO PENSIONS BIG BANG

Today's consumers rarely think twice before switching between savings accounts to get an improved interest rate or changing credit cards or mortgage providers to get a better deal. Switching pensions is less straightforward, yet every day in Britain six hundred people transfer their pension entitlement from one scheme to another.

Why have transfers become such a popular part of the pensions landscape, and what is the incentive for moving without delay? There are a number of factors at work.

First, the concept of a job for life has gone. Typically, people will have six to eight different jobs during a career, so it makes sense to consider consolidating all the resulting bits and pieces of pension entitlement in one place. This greatly simplifies the task of checking on the value of the pension fund and gauging its adequacy to meet the investor's retirement needs.

Secondly, many traditional pension providers have closed their books to new business, and charges within most of these closed funds are higher than those for more modern schemes.

There may also be concerns over the future performance of funds which are no longer being actively promoted, and which may have significantly reduced their equity shareholdings as concerns to avoid shortfalls have overridden capital growth objectives.

Transfer charges would of course have to be taken into account, but our financial advisers will be pleased to calculate whether on balance clients might be better off moving to a different pension scheme in order to take

advantage of lower charges.

There may also be potential to improve investment performance. Modern pension schemes usually offer a wide range of investment opportunities beyond the funds of the pension provider, and investors are frequently able to access funds from many well-known Unit Trust managers.

Investors considering a transfer will however need to be alert to the amount of tax-free cash available from their current scheme. Most people are keen to secure the maximise tax-free cash in order to fund capital expenditures on retirement; and there can also be advantages in using pension cash to buy a purchased life annuity (part of which is tax-free) in preference to a pension annuity (all of which is subject to tax).

Since 1988 holders of personal pensions, and more recently stakeholder pensions, have been entitled to just 25% of the value of the scheme as a tax-free lump sum, but as from 6 April 2006, when the pensions simplification changes come into force (referred to by pensions people as A Day), all pension schemes will be subject to a 25% maximum.

This could have an adverse effect on members of occupational pension schemes, including directors' executive pension plans, because these are not currently subject to the 25% cap and often pay out greater cash sums. It is estimated that there are currently around 18 million members of such schemes.

Fortunately the entitlements of these people will be automatically protected. The pension scheme will simply stop the current benefit record at 5 April 2006 and carry the record of that amount forward

on its systems until the member's retirement. The pension payments will then be subject to the Revenue's new rules for on-going revaluation to ensure that the new lifetime limit on total pension benefits of £1.5m is not exceeded.

However, the protection of tax-free cash entitlements in excess of 25% will be forfeit if the investor transfers from one scheme to another after A Day. Due to a quirk in the legislation, the tax-free cash will in this situation fall to the newly standardised level of 25%.

Consequently, those who are entitled to a tax-free lump sum of more than 25% on retirement and who are thinking about transferring to another provider, must act without delay. In fact, the sooner the better, because pension scheme administrators may not have the time or resource to process all the applications they are likely to receive.

Those most likely to wish to transfer are members of occupational pension schemes with deferred benefits, both final salary and money purchase, and perhaps some holders of section 32 buy-out plans, into which accrued occupational pension scheme entitlements have previously been transferred.

This article has mentioned only a few of the wide-ranging changes in the rules governing pension provision which will take place on A Day. There may be others which will affect clients in other circumstances. **So don't delay. Arrange to see your financial adviser now, to discuss how you can make the most of these important changes!**

INDEPENDENT ADVICE

For the past six months, a new type of financial adviser has been at large – the so-called multi-tied adviser.

To understand the multi-tie one has to go back to the late 1980s, when financial services became regulated for the first time and the legislators drew a distinction between independent financial advisers, whose duty was to advise their clients in an unbiased way, and tied salesmen, whose job was to sell the products of a single financial institution.

When considering how best to encourage more investment and savings, the Government concluded that there needed to be a middle road between independent and tied advisers and that consumers of more modest means, who were most likely to rely on their bank or building society for financial advice, would be better served if such organisations were able to recommend products from a small shortlist – the multi-tie.

So the consumer now has a wider choice. However, the basic distinction remains between those financial advisers whose responsibility is to their clients, and those whose job is to sell products and will only get paid if they succeed in selling products.

There are three other aspects of the new regime which must be noted. The first is that the banks and other organisations which have created multi-ties have demanded a heavy price from the product providers to which they have tied, in the form of inflated commission payments – sometimes up to 8.6% on lump sum investments.

The second point to note is that, confusingly, the same organisation can be both independent and multi-tied. So a client might be induced to commence a relationship on the basis that the adviser is independent, only to find that on the next occasion he has donned a multi-tied hat.

The third point is that independent financial advisers, such as ourselves, are now required to demonstrate their lack of bias by offering their clients the option of paying a fee, instead of agreeing that the adviser may retain any commission they may receive.

INVESTMENT FOR TRUSTS

It is now almost four years since the Trustee Act 2000 became law and heralded a new era in trust investment, unfettered by the archaic restrictions which had applied since 1961. Now, trustees are permitted the same investment opportunities as if they were investing their own money; and the same principle has also been extended to Scottish trusts.

Unsurprisingly, the extended powers are accompanied by additional responsibilities, and the legislation lays down four main requirements:

- Investments must be suitable in terms of their risk profile and their tax-efficiency
- In order to spread risk, they must be diversified to include holdings from across a range of sectors and markets and even managers
- The trustees must take investment advice if they are not themselves investment experts
- Trust investment portfolios must be kept under regular review.

These requirements are having a major impact on the construction of investment portfolios for trusts. Traditionally, most trusts have been invested in individual shares on the recommendation of stockbrokers, but increasingly it is being recognised that packaged investment products may be more suitable. They are more tax-efficient (and hence less expensive to administer); and they are much better diversified. The Financial Times has commented *“for most investors, collective funds are the most sensible option”*.

For larger trusts, a balanced portfolio of funds is likely to commend itself. For smaller trusts, an all-in-one solution such as fund of funds or a distribution fund might be the best way of achieving the twin objectives of suitability and diversification.

Funds of funds are the fastest growing type of collective investment and present the ultimate form of diversification, because rather than investing in individual securities, they invest in carefully selected combinations of other funds. Distribution funds, by contrast, concentrate on producing an attractive level of income from a portfolio of shares and fixed interest securities.

ISAs v VCTs

Even though dividend income received on funds held within Individual Savings Accounts is no longer tax-free, ISAs still provide valuable advantages in terms of exemption from capital gains tax, tax-free savings income, and the avoidance of any need to report holdings to the tax authorities. They should therefore be on the regular shopping list for almost every saver and investor – though preferably the purchase should not be left until the stampede at the end of the tax year.

However, there is another tax-favoured investment vehicle, which may appeal to the less risk averse, namely the Venture Capital Trust (‘VCT’). Whereas ISAs can invest in all types of Unit and Investment Trust or individual securities, VCTs invest in small and start-up companies which are either unquoted or listed on the Alternative Investment Market.

VCTs offer valuable tax breaks, in the form of income tax relief at up to 40% on sums invested of up to £200,000 (until April 2006), and tax exemption on both dividends and capital gains. However, no investment should be based purely on tax considerations and it is important to be sure of the quality of the underlying investments: which means in practice that the key to success is the skill of the manager. So specialist financial advice is vital.

As a component in an investment portfolio, VCTs have the advantage that they react differently from other investments to economic events, and the managers are driven by the need to make positive returns rather than be judged relative to market benchmarks.

The key period for VCT sales is towards the end of the tax year, when new launches are likely to take place. In general, the current tax rules favour younger higher-rate taxpayers, though income-oriented VCTs may be useful for retirement planning.

Inspiration from ex-General Electric CEO Jack Welch for those unfazed by the prospect of delayed retirement:

“Why would I want to go and sit on a beach? I haven’t run out of gas!”