

THE ADVISER.

Pension News Winter 2008/2009

Welcome to the latest edition of The Adviser, our update on developments in pension planning within financial services. Please feel free to contact us for a review of your retirement aims and objectives. We are happy to provide a free review of your current planning.

What is a SIPP?

The popularity of the Self-Invested Personal Pension (SIPP) has increased dramatically in recent years. Costs have come down, many investment providers have launched SIPP-friendly products, and the UK government has ensured many different types of investments qualify for inclusion in a SIPP wrapper.

A SIPP is a tax-efficient wrapper - a particular type of pension - which sits around your retirement fund, allowing you to select from a wide range of investment choices. It gives you great control and flexibility over the investments, allowing you to tailor your SIPP portfolio to match your investment requirements. If you are employed, your employer can also pay into the plan to help boost its value. All contributions, within preset annual and lifetime limits, receive income tax relief at your highest rate, and all investments within it will not be liable to any further income or capital gains tax (CGT).

A SIPP also allows flexibility once you reach retirement, whether you buy an annuity immediately or opt for phased or deferred retirement. However, while there are long-term benefits for those interested in the flexibility, they are not for everyone. There are set-up charges, and annual management charges which need to be weighed up against the benefits. You will also need to consider whether you need the full investment flexibility provided by a SIPP or whether the increasing range of fund links offered by more conventional plans would actually be sufficient.

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Contracting out

The state pension system is made up of two tiers - a basic state pension and an earnings-related second state pension (or S2P). S2P is based on salary, so the higher the salary, the higher the S2P (up to a maximum limit). Many occupational schemes automatically contract out of S2P but with personal pension schemes, the choice is with you, the investor. Contracting out forfeits any entitlement from the S2P in return for a reduced NI contribution or NI rebate, which can go into a private plan. Whether this performs better than S2P however, depends on whether the investments are appropriate, how they perform and whether the charges are reasonable.

Putting it off

Anyone hitting retirement with a substantial pension pot can often feel like the job is done and their comfortable retirement secured. But low interest rates mean low annuity rates and retirees may therefore wish to consider other options to maximise their income. One solution is to defer your pension payments, which, as your age increases (and assuming interest rates do not fall further), could result in higher payments.

There are three main reasons why retirees might defer payments from their pension: One, because interest rates are low and waiting a few years may help them secure a more favourable annuity rate, particularly if interest rates rise in the meantime; Two, retirees may choose to continue some form of paid employment, which can support them in the short-term without the need for their pension; Three, a pensioner may want to buy a joint life annuity, but have a younger partner. Waiting until that partner is older will secure a better rate on the annuity.

On retirement, you can take a tax free lump sum of up to 25% of the value of your pension pot. The rest is used to buy an annuity, but taking any or all of these benefits can be deferred until as late as age 75 (when your situation must be reviewed). There is also a deferment option for the state pension scheme. For every year you defer taking that income, you get 10.4% extra income which could be worth over £470 per year on a full state pension (based on 2008/09). Sometimes it pays to wait.

Drawing down the options

The latest interest rate cuts affect more than just savings rates. They also hit annuity rates, meaning the income from pension funds could also be hit. This is all very well - unless of course, you are about to retire, in which case, some ideas about how to maximise your income might be very welcome.

Income drawdown (also called an unsecured pension) is just one option to consider. What this offers is the chance to defer purchase of an annuity, leave your fund invested and in the meantime, draw an income direct from the fund. The rest stays invested until you perhaps consider it is a better environment to retire - or until age 75 when your needs must be reviewed, regardless. This allows you some flexibility in your planning. Subject to a maximum (which is defined by the Government's Actuary and reviewed every 5 years), any amount of income can be withdrawn. So, for example, if you continue working part time, you could draw just a small amount to start with, then increase it as your hours reduces. Or, you could take the tax free lump sum but leave the fund which will provide your income invested.

There are drawbacks. First, even given recent market disappointment, your fund could fall (further) in value leaving less than you have now. There are also charges for staying invested that would stop if you bought an annuity - and there are fees for carrying out reviews. Finally, there is no guarantee annuity rates will improve. However, you only get one chance to buy an annuity so you should ensure you check out all your options.



A little at a time

When the retirement age was first set at 65, nobody expected us to live as long as we are. For many who have not been able to save enough during their working lives, it will mean working harder and maybe longer. For some people, the flexibility of phased retirement may help the transition.

Phased retirement can be seen as a series of mini-retirements. Basically, your pension is split into lots of smaller identical pensions and rather than retiring all of them on the same day, you take just a few at a time over a period of years. Therefore, at initial retirement, you could take a mini tax free lump sum, plus a mini-annuity, using up just part of your overall fund. You leave the rest invested and then take more at fixed dates in future or as your needs change. Finally, you convert any remaining part of your retirement fund to an annuity at age 75.

The advantages of phasing can include the potential for further growth on the money left invested. Also, annuity rates generally improve as you get older, so later retirements should buy more income than earlier ones. However, there are also risks to consider. The money remaining invested may fall in value if markets turn down - or annuity rates may fall if actuaries decide we are living even longer. In addition, you may not be able to access your entire tax free lump sum until your entire pension is taken. Finally, there are charges involved which can eat into your fund. However, you only retire once so you need to make sure you consider every option.

Avoid last minute surprises

Investing the money you save into a pension scheme requires careful thought and advice. The investment decisions you make can have a significant impact on the size of your pension in retirement, but it need not be as daunting as it sounds.

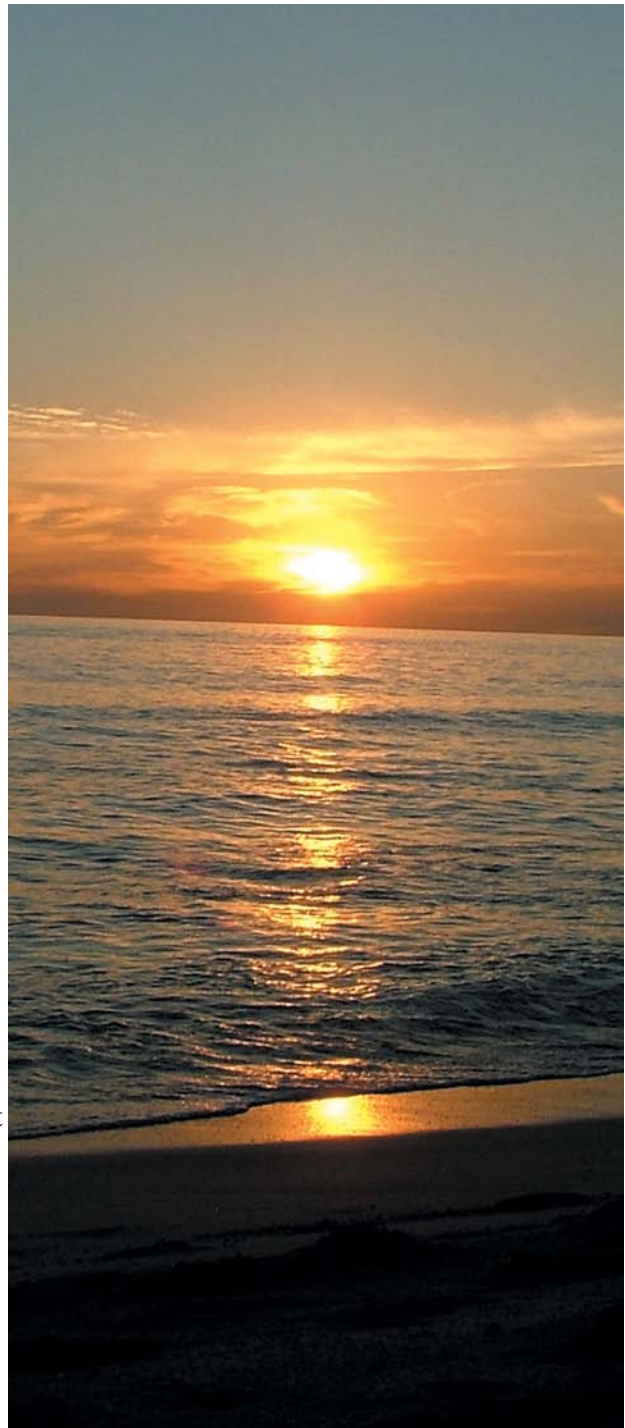
If you are in an defined benefit occupational scheme, the chances are all your investment decisions are made for you, but for those of us with money purchase and personal pension plans, the burden is on our shoulders. You therefore need to carefully consider the risk and reward involved to ensure it suits your objectives.

The range of options offered by pension providers is widening. Many not only offer a small number of their own funds but also now link up with external fund managers to offer third party funds as well. However, fundamentally, the decision is down to how you mix the four main asset classes – equities, property, bonds and/or cash – to maximise growth.

Equities have been the highest returning asset over the long-term, but are also the most risky, with the largest movements in price, particularly when measured over the short-term. Property can also fluctuate as demand is affected by the ability of companies to buy or rent premises. Bonds tend to be less volatile but are influenced by interest rates and therefore also move up and down. Cash is the safest asset class as your capital is secure – but it does not protect against inflation, there is no chance of any capital gain and income fluctuates with interest rates.

Long-term, therefore, it is common to put a greater proportion in equities, to maximise the growth potential, but to move slowly into more secure assets as retirement approaches. This ensures that any gains you make are 'locked' in, removing the risk that your pension will eaten up by any last minute downturn in markets.

It is important to carefully consider the trade-off between risk and reward. Putting all your money in one asset class will mean if that asset does badly, the whole fund will suffer. Avoid chasing attractive looking performance as there is always a risk it will fall. By that same token, don't be too cautious, particularly if you are starting early, as this could mean miss out on investment growth and your pension ends up just a fraction of what it could have been.



Pensions and ISAs

With longer life expectancies many investors are concerned about their retirement income. Some are now looking to boost their pension funds, either by topping up company schemes, or by using alternative vehicles. One such vehicle is the Individual Savings Account (ISA) which could help to ensure your retirement income is as healthy as possible.

ISAs and pension plans are both seen as tax efficient investment vehicles. However, there are big differences between the two. For example, when you put money into your pension plan, the contribution qualifies for a tax rebate at your marginal rate which, for a higher rate taxpayer, can add a significant amount to their investment. However, in exchange for this benefit, you must keep your money invested until at least age 50 (rising to 55 in 2010), and on retirement, the income you receive back is taxable, and counts towards your personal allowances.

With an ISA, the money you invest comes from taxed income and no rebate will be given. However, ISAs have no minimum term - so you can withdraw the proceeds or an income at any time you like. In addition, any income you do withdraw will be tax free and will not count towards any personal allowances. Which approach is best for you depends entirely on your personal situation. Perhaps the healthiest way to approach it is to combine the two.



The Pensions Bill

The current pension system is in need of swift repair. The retirement age was set before the dramatic increase in life expectancy but advances mean retirement that previously lasted only a few years, can now last nearer 20. It is widely reported that the state benefit system is overwhelmed but few people have sufficient alternative cover. The Pensions' Bill, introduced to Parliament in November 2006, aimed to address some of these issues and begin to build a retirement system for the future.

The Bill recommended a gradual increase in the retirement age from 65 to 68 for men AND women. It also proposed a system of Personal Accounts, to which employers, employees and the Government would all contribute. In addition, it proposed that pension benefits should be linked to average earnings. It then suggested a simplification of the second state pension system (SP2) and an end to 'contracting out'. Finally it proposed to change the qualifying period for a full state pension from 39 to 30 years which may help women, who are more likely to take a career break.

Personal Accounts are likely to be the most wide ranging reform and should be in place by 2012. Employees will be automatically be enrolled in the scheme (unless their employer runs an exempt alternative) and minimum contributions will be set as a percentage of salary. This will then be matched by a combination of employer contribution and Government tax relief.

Start early

The Government Actuary's estimates put life expectancy at 91 for a female born today. As we are living longer, it therefore makes sense to maximise your pension, and the earlier you start saving, the more money you're likely to have. Indeed, the money saved into a pension between the ages of 25 and 35 can account for up to half your final amount. The main reason is the effect of compound interest, where the interest on money you save earns interest on itself over time. Start a pension at 25, say, and at 6% pa, £50 a month would provide £100,000 at retirement (age 65). Delay the start until the age of 35 and that same £50 per month produces just £50,000.

