

# PENSIONS PLANNING

*Whatever you want to be doing in your retirement, it is never too soon to start thinking about making provision for a pension. This feature looks at pension planning in general and at the new stakeholder pensions which have been introduced this year*

## A QUIET REVOLUTION IN PENSIONS

*By Howard Jones, MFSA*

*A quiet revolution is taking place in the field of retirement provision with a number of separate, seemingly unrelated matters combining to generate opportunities, and threats, in the world of longer-term investment planning*

**T**he most obvious sign of the pensions revolution was the introduction on 6 April of new legislation governing pension arrangements. This also brought in stakeholder pension plans, which are designed to increase investors' value for money by simplifying rules and regulations and introducing a limit on the pension plan providers' handling charges.

The whole subject of stakeholder pensions is covered in a separate article (see p203). Note, though, that firms employing five or more people must have a scheme in force by 8 October unless otherwise exempted. The Occupational Pensions Regulatory Authority (OPRA) has the power to fine employers that do not comply.

An interesting development from the point of view of holders of personal pensions is not so much the attraction of stakeholder plans themselves. The opportunities

lie in the way that the reduced level of investment management charges applied to stakeholder arrangements has fed through to personal pensions already in force.

Many product providers have already taken steps to reduce charges on personal pensions (both pre-July 1988 retirement annuities and personal pensions introduced from July 1988 onwards) and a sensible move might be to check with existing providers to see if and when such amendments are to be applied to your current plans. Clearly, a reduction in the charges made for providing investment services could significantly enhance the value of funds available on reaching retirement.

### PENSION TRANSFERS

If providers will not be reducing charges on existing retirement plans, you may wish to enquire about the possibility of a nil-charge conversion to a stakeholder product. If this option is not made available, this may lead you to consider transferring your funds to another provider. Note, however, that the subject of pension transfers is one that should be tackled with great care. Guidance should be sought from an independent financial adviser authorised to provide advice

on pension transfer matters. April also brought with it changes to the tax relief system with self-employed personal pension holders contributing net of basic rate tax relief deducted at source. Higher rate taxpayers claim additional tax relief at the end of each tax year. Just to keep it simple, the changes do not apply to retirement annuities, and holders of these arrangements continue to contribute the gross amount and reclaim tax in full.

The introduction of stakeholder pensions and the reduction in management charges applied to retirement annuity and personal pension plans will, in the main, only affect pharmacists who are self-employed or members of smaller company group personal pension arrangements. In many cases they do not alter the nature of pension benefits for those who are members of occupational pension schemes.

There may, though, be significant consequences for those who at present contribute to an employer's additional voluntary contribution (AVC) scheme or those who have made individual arrangements and top up via free-standing AVCs (FSAVCs). Indeed, there may be a case for contributions to be made to a stakeholder plan instead of AVCs and FSAVCs in order

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to benefit from lower charges and increase the tax-free lump sum payable on retirement. The rules can be complicated and, again, the services of an independent financial adviser should be sought.

#### COMPANY PENSION SCHEMES

Employees of larger firms may be fortunate enough to benefit from membership of their company's occupational pension scheme. Such arrangements, often known as superannuation schemes, generally provide guaranteed pension benefits based on length of service and level of salary. The term "final salary scheme" is often used. These pension schemes are seen as representing the pinnacle of retirement provision but the current economic environment and the fact that people are living much longer than previously may be seen as representing a threat to this sort of arrangement.

Current economic policies producing low levels of inflation and lower rates of interest have been accompanied by recent stock market volatility. These factors have served to reduce the investment returns generated by the pension fund managers contracted by the trustees of large employers' pension schemes on behalf of their members. With retirement benefits being claimed for longer periods due to a combination of longer life expectancy and earlier retirement, and with demands placed on scheme trustees following recent legislative changes, some occupational schemes are beginning to suffer from the inevitable consequences of diminishing investment reserves being used to support increasing pension payments.

There is already evidence that larger employers are beginning to move away from the provision of final salary schemes. Aware of the longer-term effect on members' funds should current economic conditions contin-

ue, some firms are altering the basis of company pension schemes away from final salary schemes with their inherent guarantees. In their place they are introducing money purchase arrangements where the value of retirement benefits will not have any guaranteed amounts but will depend entirely on the performance of underlying investment funds — very much in the style of individual personal pensions. This trend makes it imperative that regular reviews of pension arrangements are carried out to ensure that eventual benefits on retirement (or earlier death) are in line with personal requirements. Steps should be taken to rectify the situation should a shortfall be established. It is far easier to correct any underprovision where there is a longer term to run to retirement rather than having to take panic measures at a late stage.

#### RETIREMENT BENEFITS

Current economic trends have also had a direct influence on the value of benefits drawn on retirement. This applies to the various types of personal pension and money purchase occupational schemes. In simple terms, falling interest rates have reduced the levels of pension income produced from annuities which are the mechanisms used to provide lifetime income on retirement.

This effect has spawned a fairly recent development in personal retirement planning in that annuity purchase can now be deferred beyond retirement. In the interim, pension income can still be generated from the plan's investment funds using an income withdrawal or drawdown plan. This generates an opportunity to retain control over the performance of the assets underlying the pension plan but brings with it an element of risk with which it is important to be comfortable.

Attention should also be paid to the investment of lump sums other than those drawn directly from formal pension plans. These may be in the form of proceeds from the sale of a business on retirement or inheritance on the death of a parent. A wide range of income generating arrangements is available, ranging from cash deposits and non-pension annuities through to more speculative stock market based plans. An independent financial adviser will provide

guidance tailored to individual requirements.

This leads us to the subject of how to improve individual retirement planning. It is important that a holistic approach is taken to this matter, taking into account all forms of savings and investment rather than those simply labelled as pensions. Clearly, pensions remain popular because contributors can benefit from tax relief although the nature of such plans is that they are essentially longer term arrangements.

An alternative may be found in individual savings accounts (ISAs) which have been available since April 1999. These offer a wide range of savings and investment opportunities from bank and building society accounts through to all types of asset-backed investments. (Note that ISA cash components are not regulated by the Personal Investment Authority.)

Immediate comparison with pension arrangements appears unfavourable, since ISAs do not attract any sort of tax relief. The investment funds themselves, however, are tax advantaged and since many ISA arrangements are open ended and do not have a fixed term, they may be seen to be rather more flexible than long-term pensions.

Note, too, that the proceeds of ISAs can be taken entirely as tax-free lump sums whereas the different types of formal pension arrangements limit the amount that can be taken as tax-free cash to a set proportion of the entire benefit available.

#### SUMMARY

**Stakeholder pensions** Lower cost retirement provision. Fines for employers who fail to comply.

**Tax relief** Now deducted at source for self-employed personal pensions.

**Final salary pensions** Guaranteed benefits but pressure on future availability.

**Drawdown** Variable income in retirement. Investment risks.

**Capital from sale of business** Range of solutions available for use but personal guidance needed.

**Alternatives to pension** Flexibility. No tax relief.

#### FINDING FINANCIAL ADVICE

- 1 IFA Promotion Ltd on 020 7833 3131 ([www.ifap.org.uk](http://www.ifap.org.uk))
- 1 Society of Financial Advisers on 020 8989 8464 ([www.sofa.org](http://www.sofa.org))

## WHAT IS A STAKEHOLDER PENSION?

By Adrian Stewart

*Stakeholder pensions are a new, low-cost form of personal pension introduced by the Government to encourage more people to save for their retirement. Companies employing five or more people and not already offering a company pension scheme will have to provide access to a stakeholder scheme from 8 October*

**T**he stakeholder pension is a new private pension; it is not a state pension. You can get a stakeholder pension if you are in employment, a fixed-contract worker, self-employed, or even not working but able to

afford contributions. You can get one from a bank, building society, insurance company, investment company, or through a financial adviser. You pay contributions regularly which are invested to build up your own pension fund. You can also pay lump-sum

contributions whenever you like. When you retire, you use your pension fund to buy an annuity. The annuity will pay you a regular income during your retirement. That income will depend on the size of your fund and the annuity rates at the time you take

your pension. You cannot withdraw any money from your fund before you take your pension. But when you take your pension you can choose to have up to 25 per cent of your fund as a tax-free lump sum. Stakeholder pensions must meet standards laid down by the Government.

**Charges** Providers of stakeholder pensions usually charge for managing your money. There is an upper limit on this charge. The limit is 1 per cent of the value of your fund each year. The charge is taken from your fund. So if your fund is worth £5,000, a 1 per cent charge would be £50.

**Flexibility** You can contribute regularly or occasionally. It is always best to make regular contributions but you can change the amount. You can pay in as little as £20, and you can stop paying in without having to pay any penalty and restart later. If you are employed and your employers provide a stakeholder pension, they may, if you wish, deduct your contributions direct from your pay and put them into your pension fund.

You can take your stakeholder pension with you when you change jobs. You can switch to another stakeholder pension at any time if you want to without having to pay any charges for the transfer.

**Information** Your stakeholder pension provider must give you regular information about your fund. This will include an annual statement to let you know how much you have paid in and how your fund is growing. It may also include a forecast of how much your pension might be.

**Tax relief** Everybody who contributes to a stakeholder pension will get tax relief on their contributions. Under present tax arrangements, for each £1 you pay into your stakeholder pension fund, the Inland Revenue will pay an extra 28p into your fund, even if you do not normally pay income tax. For example, if you pay in £50 a month, the income tax relief will increase your contribution to £64.10.

Anyone can contribute up to £3,600 to a stakeholder pension in any tax year, including basic-rate tax relief. What this means is that you could pay in £2,808 and the income tax relief would increase your contribution to £3,600.

If you are employed or self-employed you might be able to contribute more than £3,600 and still get income tax relief, depending on your age and earnings. For example, up to age 35 you can contribute up to 17.5 per cent of your earnings in any tax year. If you are over 35, there is a scale that allows you to contribute higher percentages of your earnings. The Inland Revenue sets the limits on what you can contribute to a pension scheme. If you pay income tax at the higher rate you will be able to claim back the extra tax from the Inland Revenue at the end of each tax year.

**Where can I get one?** You can buy one privately by contacting a financial adviser or a firm that sells stakeholder pensions. You will

## Stakeholder pension schemes for pharmacies

Stakeholder pension schemes for community pharmacy owners to offer to their employees are being set up by the National Pharmaceutical Association, UniChem and AAH Pharmaceuticals. The schemes provide information packs including checklists, guidance notes, posters and application forms.

- 1 The NPA scheme is being run in association with Scottish Widows. The information pack for the scheme contains a CD-ROM with sample letters and announcements and a Power Point presentation for staff. The management fee is 0.6 per cent of the fund per year. Further details can be obtained from the Scottish Widows NPA helpline on 0845 733 0803.
- 1 The UniChem scheme is being run in association with NPI Financial Services Ltd. The information pack for employees contains decision trees that explain whether stakeholder pensions are appropriate and application forms. There is a maximum management fee of 0.85 per cent of the fund per year. Further details can be obtained from Phillip Warner at UniChem on 020 8391 8112.
- 1 AAH Pharmaceuticals will be offering a stakeholder pension scheme for its customers but details of the pension provider have not yet been finalised. Pharmacists who are interested in obtaining further details when available can contact Robert Andrews, director of AAH's financial arm Statim Finance, on 024 7643 2000.
- 1 An Inland Revenue guide to stakeholder pensions is available from 0845 764 6646.

see stakeholder pensions advertised widely, for example, in the newspapers or at your local bank or building society.

A full list of registered stakeholder pensions is available from the Occupational Pensions Regulatory Authority (OPRA) website ([www.stakeholder.opra.gov.uk](http://www.stakeholder.opra.gov.uk)) or call the OPRA help desk on 01273 627600. The helpdesk is open from 9am to 5pm, Monday to Friday.

Do not assume that the first advertisement you read or the first salesperson you talk to has the best deal. Shop around and find out what else is on offer. Some stakeholder pension providers may charge less than 1 per cent a year. This is worth looking at because charges can have a major effect on your pension, particularly if you hope to build up a substantial amount of money in your fund over the years.

**Default investment** All stakeholder pensions have to offer what is called a default investment option. If you do not want to choose a particular investment fund when you take out your stakeholder pension, your contributions will be invested automatically in the default fund. If you want more choice in how your contributions are invested, look at stakeholder pensions that have a wide range of funds.

**Personal pensions and company schemes** Whether or not you are currently making payments into your personal pension, contact your pension company or financial adviser to find out how the annual charges of your existing personal pension compare with a stakeholder pension. You also need to check if there would be any charges for switching. Although stakeholder pensions are designed to be cheaper to run than most personal pensions, you should not switch to

a stakeholder pension without getting advice. If your employer already has a pension scheme for employees and you have not joined it, check out your employer's scheme before you do anything else. In the majority of cases, joining your employer's scheme is the best way to save for your retirement — especially if your employer contributes.

**Providing stakeholder schemes** Employers will normally have to provide access to a stakeholder pension by 8 October if they have five or more employees and do not provide a pension scheme for staff at the moment (see Panel, above). Some employers may not realise they have to do this, and some may be confused about the choices they can make. Because stakeholder pensions have no up-front charges, they are designed to be cheaper to run than most of the other pension schemes available to employers. If your employer is going to provide access to a stakeholder pension, ask if they intend to make a regular contribution for employees. If so, it is usually a good idea to join its stakeholder pension.

**What rights do I have?** All firms that sell stakeholder pensions must give you a copy of their key features document before you sign up. This sets out basic information about the product, such as the charges and the investment choices available, and will help you compare stakeholder pensions.

When you have signed up to a stakeholder pension, the stakeholder pension company will send details of your right to cancel. This right lasts for at least 14 days. After this you can only get access to your money when you draw the benefits, which cannot be before the age of 50.

The above commentary is a basic guide to stakeholder pensions. The information contained in this article is for guidance only and expert advice should be obtained before any action based on it is taken. It is also based on our understanding of current Inland Revenue practice and legislation.

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