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Provident Money

Your independent *window on financial issues*

Autumn 2005

Pension changes just months away

The way pensions operate changes on 6th April 2006. For many people there will be little practical impact; just some improvements. But not everyone is better off and seeking individual advice could be a good idea.

Most people recognise that pensions are far too complicated. Too much time is spent on technicalities and not enough on other aspects of pension planning, such as making sure that contributions are adequate and investment strategies match objectives. The reason for this is that the rules have grown up over about 100 years and the nine sets of rules really need to be brought together.

This is what 6th April 2006 is all about. From then on, only the Basic State and Second State Pensions (plus Graduated and the State Earnings Related Pension Scheme (SERPS) for those with a longer earnings history) will remain outside the new system. For everything else, one set of rules will apply.

From that date, everyone will be able to:

- Contribute up to an annual limit of £215,000 for the tax year 2006/7 (indexed thereafter)—however **tax relief** is limited to £3,600 or **actual earnings** for the year, up to the annual limit;
- Build up a total pension fund limit initially set at £1.5 million (or a defined benefit pension initially of £75,000 a year), also indexed;
- Take up to 25% of their pension fund (including on "Protected Rights" benefits built up by those who have "contracted out" of SERPS or its replacement the State Second Pension (S2P) and Additional Voluntary Contributions) as a Pension Commencement Lump Sum (formerly Tax Free Cash)—but see "A new form of retirement income" on page 2;
- Have far greater asset choice, through self invested personal pensions (SIPPs) or small self administered schemes (SSASs);
- Retire without having to purchase an annuity, before age 75; and
- Use an Alternatively Secured Pension after 75.

Tax relief on contributions will be allowed at the highest marginal rate against all relevant income within the UK.

Sailing may not be *your* dream of retirement, but it would be good to have the choice

One downside is that, from April 2010, the earliest age at which pension benefits can be taken for most people will be 55, rather than the current 50.

For those who have built up—or are on the way to building—very large pension funds, or who may currently be entitled to more than 25% tax free cash at retirement, there is an extra dimension.

They may wish to continue benefiting from the current rules and can do so by applying for Primary or Enhanced 'protection'. The rules are relatively complex, but this status need not be applied for immediately; there is a three-year window in which to do so. However, it may not be possible effectively to make further pension contributions after 6th April, in some cases, and it is therefore essential to have a good idea as soon as possible, if you may wish to go down this route.

If 'protection' is not applied for, pension providers must still honour higher tax free cash entitlements if the member can prove membership of a scheme granting such rights *and* does not transfer out of the scheme on or after 6th April 2006.

In this issue:

☑ Pension simplification will be with us soon, what does it mean to you?
☑ In the world of investments, comparing risk and reward is essential. Careful asset allocation can help achieve objectives.
☑ Knowing about your family's medical history is essential, if you are to improve your health and potentially save money.
☑ If elderly relatives need to access cash, perhaps for inheritance tax planning, their home could hold the answer.
☑ Businesses can suffer from the loss of a key person, just as much as a family would miss a breadwinner.
☑ Back page briefing—if an offer looks too good to be true, it usually is.

Investing to meet objectives

One of the issues that we have to address is what sort of investment strategy is most suitable for us; there are, after all, so many alternatives.

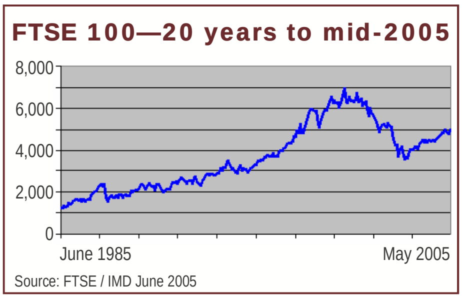
No one strategy is suitable for everyone and decisions must be based on a number of criteria. For example, there are different types of risk, including:

- Possible loss of capital—that your money will disappear completely;
- Possible relative underperformance—that other alternative investments could do better;
- Possible absolute underperformance—that your investments may grow, but at a lower rate than inflation; and
- Possible volatility—that the value of investments will fall just when access is required.

When looking at your 'attitude to risk' we are therefore actually considering your view on different *types* of risk, because not all will occur at the same time, or impact in the same way.

Most importantly, the timescale during which access is likely to be required will be critical. If, for example, you might want to get hold of some of your investments quite soon—perhaps to cover education costs or for a special purchase or holiday—investing in equities or property might not be a sensible idea. The costs involved are generally much higher than for deposits and a longer time is therefore needed for investment growth to overcome these. What's more, equities are particularly susceptible to short term fluctuations and property investments can take time to realise.

The chart shows how the value of shares in even the largest UK companies can fluctuate significantly over short terms while having historically offered long term growth.



In general, while past performance can never be taken as a guide to the future, equities have traditionally been viewed as offering the best long-term growth potential, while property can also do well, but is less easily 'accessible'. So in looking at short term needs the risk of absolute underperformance, where net interest rates may fall below the rate of inflation, may be more acceptable than the costs and volatility associated with alternative forms of investment.

In addition, however, it is important to look at asset allocation strategies within each asset class. If, for example, your needs and attitude towards risk suggest that 50% of your investments should be in equities, 25% in property and 25% in cash, it is then necessary to consider both geographical and sector allocations within the equity market. In other words, what proportions should be held in UK and overseas equities, or specific share classes?

Our job is to compare your objectives with what is available and guide you in the direction that gives most chance of you achieving your goals.

Key points:

- There are many different forms of risk, affecting various investment strategies;
- Matching risk to objectives gives a better chance of success;
- Asset allocation will impact on overall returns.

A new form of retirement income

From April 2006, there will be a new way of drawing a retirement income called a "scheme pension". The member will be able to draw an income directly from the pension scheme itself, rather than buying an annuity. One of the curiosities of this is that those opting for a level income with no spouse's pension may actually be able to secure a larger Pension Commencement Lump Sum than the usual 25%. It is difficult to see how this chimes with the government's objectives of encouraging people to secure the best possible income in retirement.

Despite the change in name from Tax Free Cash to Pension Commencement Lump Sum, this will continue to be tax free.

This article is based on our understanding of the rules and practice as at 6th May 2005, which may be subject to change, particularly as there are some technical drafting issues within the Finance Act 2005 still to be resolved.

It is important to seek independent financial advice before making any decision regarding your family finance.

How healthy is your family?

Insurance companies are increasingly asking questions about your family, when you apply for life or health insurance – we consider the reasons behind this – and how you can speed up the process.

According to Norwich Union (news release 8/2/2005), almost nine out of ten doctors think patients know **too little** about hereditary medical conditions that affect their families. Their research was based on interviews with more than 200 GPs throughout the UK, which also questioned more than 1,000 adults about their own health. At an individual level, a third of us don't know much about our own parents' and siblings' health history and have little confidence when answering our own GP's questions on the topic.

How many people really know about family health

Historically, GPs would have known the family's medical record; but few of us now live in the same area for a long time and, even if we did, how many GPs have sufficient time to learn about each patient, let alone their family?

Doctors do not have the time they once enjoyed

Family history is important because we inherit genes from our parents and share them with our siblings. So any trends in the family, such as diabetes, heart condition or other hereditary conditions, could affect us.

The greatest impact can be on health, critical illness and medical insurance, but straightforward life insurance is also affected by family history. After all, if your parents lived to 90, there is no guarantee that you will not walk under a bus, tomorrow; but the statistical probability must be that you can expect to live a reasonably long time.

Genes run in the family

On the other hand, if your father and grandfather suffered from an hereditary illness that affected them at a relatively young age then, unless there have been medical advances in the area concerned, you may be likely to suffer from a similar condition. Or some forms of cancer can particularly affect the women in a family.

Knowing about your family's health record can have several benefits. It can help speed up the process of obtaining life assurance *and* potentially save you money. This is because knowing something about any medical conditions you may suffer from could help you clarify information for the insurance company, reducing the risk of increased premiums.

But, perhaps of greater importance, is that if you know about a congenital or hereditary condition that could affect you and your children, it may be possible to make lifestyle changes that actually reduce the possibility of you becoming affected – or at least to mitigate or delay the impact.

Taking control over our health can potentially improve longevity and enhance quality of life. And any savings that can be made on health, medical expenses and life assurance costs can be used to invest for the future, so that you can enjoy the benefits yourself, rather than spending too much money on protecting your family and yourself against misadventure.

You should seek independent financial advice before making any decision regarding your family finance.

Key points:

- Knowing your family history could save you health problems later;
- It could also save you insurance premiums if you act on health issues.

Releasing equity from your home

Where once 'equity release' was seen as a 'down-market' product with a poor reputation, suitable only for those in urgent need of cash.

Today, it is seen more as a form of financial planning and can be used not just to raise cash for specific purposes but also as a form of inheritance tax planning.

But it is important to note that this is not a panacea; there are times when it is appropriate to use and others when it is not. Most importantly, it should only be used when there is a real objective in mind; simply wanting to have a little cash in the bank is not best achieved in this way, since the implicit costs are invariably greater than the interest rate that might be expected.

The term 'implicit costs' refers to the fact that schemes normally require no actual payment to the company providing the cash, the costs are all rolled up into the deal in some way or another, to be repaid when the property (or its replacement) is eventually sold.

There are two primary forms of Equity Release:

- **Lifetime mortgages**—a loan is granted against the value of the property and both the principal and interest roll-up to be repaid together when the homeowner(s) die, or no longer live in the property, perhaps because they have gone into long term care; and

A home can become a cash generator

- **Reversion schemes**—part of the home is sold to the company concerned and both it and the homeowner(s) participate in future growth (or falls) in the value of the property in proportion to their share.

Under a reversion scheme, the amount realised will be less than the value 'given away' because the company providing the cash has to make a profit somehow. In general, the older the homeowner, the more cash that can be provided.

The leading providers of this service have banded together to form a Safe Home Income Plans group, with its own code of practice. **The Financial Services Authority does not currently regulate reversion schemes. Please ask for further information about Lifetime Mortgages. Charges may apply.**

SHIP code of practice

- SHIP members provide fair, simple and complete presentation of their plans.
- Client's legal work is always performed by a solicitor of the client's choice.
- The certificate will clearly state the main cost to the householder's assets and estate.
- All SHIP plans carry a "no negative equity" guarantee.

Protecting your business

Most businesses have one or two people who are absolutely essential to corporate survival. This is usually the managing director or a top salesman. But this is not where the story ends.

In today's business environment, losing a key computer programmer, administrator or even a transport manager can do untold harm to a business by denying them access to clients, providing a less efficient service, or simply missing delivery dates.

Yet protecting the company against the impact of losing the services of a key employee through death or long term incapacity need not be expensive and can be easy to arrange.

Losing a key person can hit any business hard

Cover should be set at a level adequate to cover the loss of profit associated with any possible downturn in business if the key employee is lost, as well as the additional costs associated with recruiting & training a suitable replacement. Even if the replacement is of as high a calibre as the lost person, there will be a bedding in period while they acclimatise and this can result in a loss of profit to the business.

Of course, the greatest harm to any business can result from the loss of a controlling director or partner. If the right arrangements are not in place to cover such eventualities, the surviving principals could well find that a new part-owner has different business (or personal) objectives and this could make it difficult for the business to move forward, as before.

A "business will"—effectively part of the partnership agreement or articles of association—should make it clear what happens to shares in the event of the death of a principal.

Insurance cover can be arranged to cover the costs associated with purchasing the deceased partner's interest.

Back page briefing—Some e-mail scams to miss

Looking after your money isn't just about good investments and adequate protection. There are people out there trying to get hold of your money by fair means and foul—and they are using some fairly sophisticated techniques, as well as some rather obvious ones.

Identity fraud is most commonly associated with the theft of credit card details over the internet, telephone, or when you give your card to someone who walks away with it, cloning the details before returning it to you, following a perfectly legitimate transaction. Or when someone looks through your rubbish to find discarded documents that can be used to support opening a bank / credit card account in your name.

You can protect yourself against these by ensuring that you never give details over the phone unless you know exactly who you are speaking to, never putting card details onto a website that is not 'secure' (generally identifiable by the prefix "https://" before the "www" in the domain name &/or a small closed padlock in the bottom right hand corner of the screen).

But the internet can also be used by criminals to gather bank account details from you through several types of seemingly innocuous e-mail approaches. We have collected just a few, over the past month.

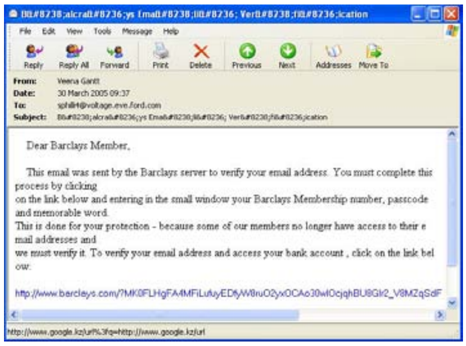
One of the easiest—and most difficult—to spot is the e-mail from a bank asking you to confirm your details or log on to check them. This is easy to spot if you know you don't bank with the (apparent) originator, but can be more difficult to see, if you do. In fact banks never contact you in this way, but when the address to click on looks perfectly legitimate (as in the illustration) it can be harder to spot. In this case the hyperlink shown indicates a legitimate Barclays Bank domain name, with a highly plausible looking extension after the "/". Surely, if the domain name is right, the rest must be OK?

Well, no; if you hover your mouse pointer over the link (but please do not click), the actual address you are being directed to appears in the bottom left hand corner of the frame. In this case it most certainly isn't a Barclays Bank address. We have seen similar e-mails from banks we do use, but many of these are quite amateurish with the illustrations not appearing correctly and even spelling errors in silly places.

In one really subtle attack an e-mail apparently from eBay included most links to the legitimate US (rather than UK) eBay website. Only the one you actually clicked on to perform the "verification" to which the e-mail refers, is actually a disguised link to a non-eBay webpage. Fortunately, there were so many spelling errors in the e-mail that it looked suspect from the start.

As a golden rule, never respond to such emails or click on links provided. It you wish to investigate, type the domain name into your web browser yourself and see where it takes you; but even then, caution is recommended.

Another form of scam common within the internet is the request from overseas to help expatriating massive lumps of money, of which you will be able to retain a large percentage. This almost invariably involves some



form of illegality in the country concerned—or it would if the money ever existed.

These e-mails once made it obvious that you would have to part with some money up-front—just to start the process going—but no longer do so; at least not the six we collected during April. But the process is usually the same. You have to respond to the e-mail, which tells the criminal responsible for initiating the spam in the first place that you exist and that the e-mail address is actively monitored.

This means they can send more spam to you, as well as initiating the process that will lead to you giving them your bank details—so that they can credit you the money, of course. What they actually do then is systematically to plunder your account by various means.

As the wise man said (well it's attributed to Milton Friedman, anyway): "There ain't no such thing as a free lunch."