Provident Solutions

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Provident Money

Your **independent *window on financial issues*** **New Year 2006**

Give your finances an early spring-clean

All too often, we look at issues from one perspective, without 'looking in the rear view mirror' to consider effects rather than causes. And this can apply to our finances, just as much as other aspects of our lives.

Consider, for example, how you and your family might cope if a carer, rather than a principal breadwinner, were to die or be incapacitated through accident or injury. There is no immediate loss of income, but costs can escalate. For example, assistance will be needed in respect of all aspects of running the home and caring for children—or elderly relatives—not to mention the inconvenience associated with running the person concerned to and from hospital, or worse.

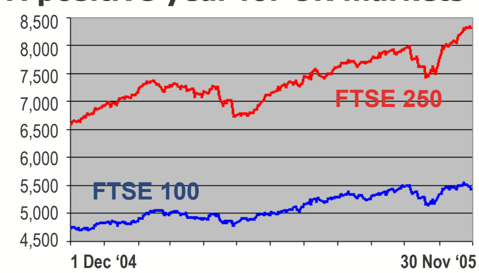
Or supposing your income suddenly stopped, either through redundancy or perhaps because you have retired early. Would you be able to survive on a reduced pension, or state benefits, or would you have savings that allow you to retain a degree of independence?

Then there is always the unexpected; a sudden need to replace your car, or wanting to replace your kitchen or living room furniture. In the past many people would have considered increasing their mortgage for this purpose, but with personal indebtedness hitting more than £1 trillion during 2005, this is an option that not everyone now wishes to adopt.

Planning for ever increasing education costs for the children is also something to which careful consideration needs to be given, not just because school fees are rising, but also so that we can help our children avoid taking on too much debt as they go through university.

What this all comes down to is that there are so many different things that can 'go wrong' in our lives that holistic financial planning is essential, whatever our circumstances.

A positive year for UK markets



Fortunately, we as Independent Financial Advisers are well placed to help you undertake the review process necessary to identify—and then plan for—all the possibilities. Of course, the process is not a quick one; nor is it a one-off exercise. Your circumstances will continue to change throughout your life and this demands regular and detailed reviews.

Your finances may need more of a clean out than your home

Our independence is your assurance that we are on **your** side. We are not employed by—or tied to—one insurance company or unit trust provider nor, like the new class of 'multi-tied' agents, are we representatives of just a few companies.

As Independent Financial Advisers, we are able to identify your various needs, based on a thorough understanding of your personal circumstances, and then propose solutions. These may not always involve new plans or investments, but simply changing the way things are done, in order to achieve the desired results.

One way or another—either through fees or commission—you pay for our professional services; and that is precisely what you can expect to receive.

We will be pleased to help you re-assess your current financial position and ensure that you are ready to meet the financial challenges of 2006.

In the meantime, have a very Happy New Year.

A new way to protect your family

Many occupational pension schemes provide life assurance cover—sometimes up to four times salary—and personal pensions can also provide 'death benefits', but changes next April will make matters easier.

At one time, those eligible for a personal pension—which broadly meant anyone who was not an occupational scheme member—were able to spend up to 5% of their 'net relevant earnings' on life assurance to provide a lump sum should they die before retirement. Most (but not all) plans also provided a return of the pension fund on death, as well.

This was changed from 6th April 2001, so that new policies would be limited to a premium representing just 10% of the amount being spent on the personal pension. It was therefore no longer possible to purchase stand-alone term cover (unless you had a separate personal pension elsewhere) and a personal pension contribution of £100 a month would provide only limited life cover, based on a premium of just £10 per month. Existing plans were allowed to continue despite the change and still receive tax relief.

The reason that pension life cover is so valuable is that, unlike conventional life assurance-which lost its tax relief (at half the basic rate of tax) in March 1984—life cover written under the pension rules attracts tax relief at the individual's highest marginal rate. So a higher rate tax payer saves 40p in every £1 of pension term premiums.

The good news is that, while the final Revenue rules have still—with less than three months to go—to be published, it will soon be possible for those with earnings of more than £3,600 a year to spend their entire income (up to the annual contribution allowance initially set at £215,000 for 2006/7 and rising thereafter) on pension contributions **including life assurance**. Those with earnings of less than £3,600 will be able to spend up to this amount on pensions, including life assurance.

Pension term cover could ease the financial strain

All contributions will attract tax relief at the highest marginal rate and personal (as opposed to employer) contributions will be paid net of basic rate tax relief. So a £50 a month premium will cost just £39 a month, with higher rate tax payers receiving an additional £9 a month relief either through their tax code or end of year tax payments, as appropriate.

But before you rush out to purchase millions of pounds worth of pension life cover, it is worth noting that any payments made by the insurance company will actually count against your lifetime allowance. So if, for example, you purchase pension life cover of £1,000,000 and have built up a pension fund of £600,000 and then die during the 2006/7 tax year, your total pension pot, at £1,600,000 will be £100,000 more than the then lifetime limit. This would result in a tax charge of about £55,000. However, like the annual contribution allowance, the lifetime limit will rise each year, so this is a moving target.

It is also worth being aware that many insurance companies traditionally required higher premiums for pension life cover—apparently to cover their increased costs in recovering the tax rebate—than for ordinary 'term' cover. And, of course, life assurance costs rise with age; so going out to change your cover on 6th April 2006 might not be a practical option. It will, however, be worth taking a look.

The other point—although this is unlikely to affect most people in practice—is that money spent on pension life cover reduces the amount you can spend on retirement benefits.

Key points:

- Pension term cover is now only available as part of an occupational pension scheme or in conjunction with a personal pension.
- From April 6th 2006, it will be possible to arrange stand alone pension term cover for substantial sums.
- Lifetime limits will apply to the aggregate life cover and pension fund.
- Premiums may be a little higher, but there will be tax relief.

A-day is coming, don't get caught

With pension taxation due to change forever in just a few months time, it is worth looking at some last minute decisions you might wish to take before then.

While the majority of changes will be to the benefit of most people, there are some which will make it more difficult to achieve some goals. For example, some executives might be funding for maximum tax free cash; which for members of occupational pension schemes can be up to 1½ times salary, (even in the case of older schemes if this uses up the entire fund). Although this flexibility will survive the changes for existing schemes and transfers to other occupational schemes or 'Section 32' plans, it will no longer be possible to establish such benefits; everyone will be subject to a maximum of 25% tax free cash. So anyone wishing to take advantage of this rule should consider making a contribution **before** April 6th.

There are some decisions to make before April

Similarly, Individual Retirement Annuity contracts—the precursor to personal pensions—currently allow high earners to contribute more than personal pensions, since the earnings cap (set at £105,600 for 2005/6) does not apply (although the age related percentages of earnings are lower). It could therefore be worthwhile maximising contributions this year, in order to minimise tax liabilities.

Employers wishing to make very large contributions in respect of employees, into an occupational pension scheme may also wish to consider doing so before the end of the current tax year, since new rules about maximum funding and contribution spreading will come into effect on A-day.

'Raiding' the bank now to buy commercial property could be a good idea

For those interested in self invested pensions, it is also worth noting that the borrowing limits for property purchase *after* April will be substantially less than are *currently* allowed for some individuals.

Instead of a small self administered scheme (SSAS) being able to borrow almost half the value of the scheme plus three years' normal contributions, or a self invested personal pension (SIPP) being able to borrow up to 75% of the property's value, after April 6th, borrowing for both will be limited to a straight 50% of the value of the fund.

But—and this is most important—it will be possible to continue loans set up before A-day, afterwards. So buying commercial property sooner, rather than later could be a very good idea.

Finally, it may be that your pension scheme is likely to exceed the lifetime limit (set at £1.5 million for 2006/7 and rising thereafter) by the time you retire.

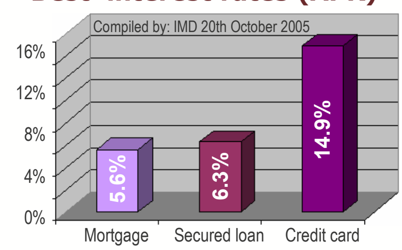
If so, you may wish to apply for 'enhanced protection' to avoid a 55% tax charge on the surplus if taken as a lump sum (25% if taken as income) when you eventually take your benefits. But although you do not have to make a formal election for up to three years, you **must stop contributing by 5th April 2006.** Please contact us if you would like to discuss these issues.

Key points:
- 'Last opportunity' to fund for maximum tax free cash.
- Use up maximum contribution limits for 2005/6.
- Maximise 'special' employer contributions.
- Borrow for property purchase.
- Decide if 'enhanced protection' might be appropriate for you.

Unsecured loans: devilish or saintly?

Secured loans have, in the past, been seen as the poor relation to mortgages, because they were invariably more expensive and were not regarded as 'mainstream'.

'Best' interest rates (APR)



While it is still generally true that secured loans are more expensive than mortgages, the differential is no longer as marked as it once was. The table shows a snapshot of interest rates on one day in October 2005 from Northern Rock (mortgage), First Plus (secured loan) and Nationwide (classic Gold Visa).

While these rates should not be taken as typical, it does demonstrate that someone with a good credit history could be far better off with a secured loan than, for example, using a credit card to obtain money, while the cost of a mortgage is very little less.

Lenders tend to charge higher interest rates, the greater the risk of their being unable to recover the money they lend. That is why a mortgage has traditionally been the cheapest source of money, since it represents a 'first charge' on the property. A secured loan, on the other hand represents a 'second charge'; that is the lender has to wait in line until the mortgage lender has been repaid before he can recover his money.

YOUR HOME IS AT RISK IF YOU DO NOT KEEP UP THE PAYMENTS ON A LOAN SECURED ON IT.

But this compares favourably with a credit card, or many other forms of unsecured borrowing, where you could find that you are paying a much higher interest rate. What's more, even through the loan is not secured on your home and other assets, a lender can still claim repayment from your assets; after those with a higher charge have been paid, of course. For those with substantial equity within their home, it therefore makes little sense to use any form of borrowing that demands a high rate of interest, when others are available.

Key points:
- Borrowing money is less expensive the more security you can offer.
- Credit cards may be convenient, but they seldom offer good value unless you repay the balance every month.

I leave my business to …

In the last issue, we briefly touched on the issue of a "company will"; and while this might sound bizarre—after all companies don't die—it certainly makes sense to consider what will happen to a business if one of the owners suddenly dies or falls ill for a long time.

Most businesses will consider the impact on their profitability if a key salesman or executive—for example the finance director—should die or become very ill. What might not be quite so obvious is what might happen to the business on the death or long term incapacity of one of its owners. Whether a partnership or limited liability company, a formal agreement should indicate what will happen under these circumstances. If not, ownership of (part of) the business could easily end up in the hands of those who do not share the objectives of the remaining owners and directors.

After all, in setting up the business, the original participants will have had a clear objective about what they wish to do and how. In general this is likely to be a series of business oriented goals, although at the back of these is likely to be a series of financial targets and even an exit strategy.

But the new owners may not share the same aims. For example, where the original owners may have had a ten year plan, the new owner might wish to realise the value of their share in the company quickly. Should this happen, there could be an enforced sale, or at the very least conflict between the new and old owners.

Losing a founder can be a major setback

To avoid this situation, ensure that the partnership agreement or articles of association are modified to reflect what the current owners want to happen, should one of them die, or become too ill to carry on. This so called "company will" can be handled in a number of ways so professional legal advice is essential.

The other aspect of the solution is to ensure that there is sufficient money available to allow the aims of the "company will" to be achieved through life assurance and permanent health insurance. This can be arranged in a number of ways; for example, by each person insuring themselves for the benefit of the others in agreed proportions, or by "cross-life" arrangements, where each insures the other.

Alternatively, the company itself may be the right vehicle for arranging suitable protection using so called "key man" insurance. In this case the costs might potentially be allowable business expenses, although if they are, the benefits are also likely to be subject to tax as revenue.

And don't forget that a "directors' loan account" will normally have to be repaid on death so you must ensure that the company is in a position to repay them, when necessary. It is important to ensure that arrangements do not become out of date; increasing value of the business should be reflected in higher sums insured.

We either arrange protection plans with a range of providers or just one, as outlined in our Initial Disclosure Document. Although the Financial Services Authority does not regulate "company will" writing or legal services, it is always important to seek independent financial advice before making any decision regarding your finances.

Back page briefing—Boiler Room Scams

There has been an increase in the number of reported 'boiler room' scams recently and these are a perfect example of why independent professional financial advice is so important.

Successful financial planning is not just about looking for new opportunities and matching risk profiles to investment strategies. It also involves thinking holistically about the place of investments within an overall financial structure that covers family protection, long term financial commitments and goals, and tax planning.

That is why we are so concerned when offers appear on the horizon that seem absolutely unmissable; at least on the face of it. But the old adage remains relevant; if an offer sounds too good to be true, then it probably is.

The most recent issue has been the appearance of so-called 'boiler room' scams which, despite the best efforts of regulators are still being offered to investors by "high-pressure" sales tactics—usually over the telephone.

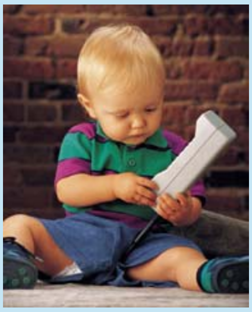
You may know how it goes. A telephone call from someone who turns out to be overseas (the time lag is often a bit of a give away, but not always) who has a special tip for you; if you would like to buy the shares they are offering, you are bound to make a profit. They never seem to know the answer to the question: "if this is so good, why are you not making the investment yourself and keeping quiet about it?"

We have, when receiving such calls as private individuals, made it clear that we only deal with firms regulated in the UK by the Financial Services Authority, but that does not seem to put them off. This is unsurprising, since they are invariably beyond the FSA's reach, because they can be located anywhere in the world.

The problem is, of course, that the offers never materialise. In general, the shares might exist and you could even get a certificate in what looks like – may even be – a legitimate company. But the price rise, if any, is usually based on the increased demand that is generated by the high pressure sales tactics and as soon as the price moves, the company promoting them is likely to dump their shares and move on. They will make a profit, few if any others will do so.

And more importantly, from a financial planning viewpoint, the deal is never put into the context of an integrated investment strategy that takes due account of asset allocation and risk exposure.

The best advice on receiving such a call is undoubtedly to hang up – this is invariably a telephone approach. The sales techniques adopted are high pressure and subtle so even the most hardened investor could feel under pressure.



Passing the telephone to an expert in double talk could be best

What's more, they can be like Boy Scouts in bob-a-job week (yes, it's still about); give them any encouragement and they will simply keep coming back. And you'd probably get better value from the Scouts, anyway.

If you do consider listening to what they have to say, you should at the very least ask some probing questions about themselves, their company and how they are regulated. After all, if it is genuine you might learn something; if it isn't – well, it's their telephone call …

In the end, these offers usually boil down to (unsubstantiated) claims about "guaranteed" profits; but ask yourself, who is guaranteeing what? Do you know and trust these people?

It is always important to seek independent financial advice before making any decision regarding your finances. If you would like any assistance, please contact us.