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A New Direction for Pensions

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On the 6th April we saw a massive change in the world of pensions that will impact all pensions investors.

Known as A-day, a new set of rules aimed at simplifying the administration and taxation of pensions took effect. The changes will alter the rules for all existing pension schemes and their members as well as all new members and new schemes.

As a result of these changes it is vital that your pension arrangements are reviewed.

A new lifetime allowance has been introduced, which will effectively cap the maximum tax efficient size of a pension fund at £1.5m, rising to £1.8m by 2010/2011. Exceeding this limit may trigger heavy tax penalties.

The new rules introduce much greater flexibility in terms of drawing benefits at retirement and with regard to your investment options. However, if your pre A-day pension provider has not modified your scheme rules, you may miss out. Also, the rules affecting the availability of tax free cash at retirement have been radically altered. It is therefore crucial for you to assess whether you are affected and if so, to review your options going forward.

On the other hand, the changes may benefit you by allowing significantly more tax free cash if you are a member of an occupational scheme and greater flexibility in respect of how and when you can draw your retirement income.

As you will appreciate, gathering information about your existing pension can take some time and so the sooner you contact your adviser and request a review meeting, the sooner you will be able to take advantage of any new opportunities that A-day may have created for you. Call your adviser today, or alternatively simply call us on the **FREEPHONE** number below and we will arrange for your adviser to call you back.



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Contact us on 0800 032 1419

Keep faith with trusts

Colin Jelley, Head of Tax and Financial Planning At Skandia and Chairman of the Product Taxation Panel of the Association of British Insurers looks at the recent changes to the Inheritance Tax (IHT) Treatment of trusts.

The introduction of the Finance Act on 19 July 2006 brought with it significant changes to the taxation of trusts, encroaching on some of the previous advantages. However, this is not to say that trusts should not still be considered and indeed they can still play a vital role in financial planning. Rather than be put off, people who already have assets or policies in trust, or are considering doing so, should seek guidance from a financial adviser in order to explore the reasons why a trust might still be the best solution to a financial planning problem.

The fundamental reasons why trusts may be appropriate have not changed. By holding benefits in trust, families can ensure that money passes to their chosen beneficiaries at the right time, probate delays can be avoided and trusts can make it possible to act for minors who are not yet in a position to take sensible financial decisions themselves.

The changes brought in by the Finance Act mean that lifetime transfers into interest-in-possession (IIP) and accumulation and maintenance (A&M) trusts, which were previously treated as potentially exempt transfers (PETs), have been brought in line with discretionary trusts for inheritance tax purposes. Any gifts into IIP and A&M trusts that are over the IHT nil rate band (£285,000 for 2006/2007) will incur a 20% tax charge at the start, a charge of up to 6% every 10 years and when money is paid out.

Despite the new tax regime, it is important to remember that the new tax burden can still be less than paying 40% inheritance tax. Gifts up to the nil rate band of £285,000 are free from tax. So for example, assuming you live for another seven years, a gift into trust of £300,000 will pay a 20% tax charge on just the £15,000 that exceeds the nil rate band. This amounts to £3,000 which is just 1% of the total. As the size of the gift increases, the percentage tax will also increase, so a £500,000 gift will pay 8.6% tax (£43,000) and a £1m gift 14.3% (£143,000), but this is still substantially less than 40% inheritance tax, although consideration will also have to be given to charges that may be payable every 10 years and when money is paid out of the trust. Also, if you die within seven years, additional tax may be payable.

Trusts still have an important part to play in conjunction with life assurance policies, with payments to the trustees upon death falling outside the individual's estate for IHT. People holding life assurance policies in trust and paying regular premiums are unlikely to have to pay tax charges either. In most cases premiums will fall under the £3,000 limit that all of us are allowed to give away each year tax free. Higher premiums may also be exempt, so long as they are paid out of income, considered to be normal expenditure and do not decrease the person's standard of living.

In addition, life policies held in trust are unlikely to be affected by the charge that occurs every 10 years because it is based on the value of the policy at that time, which for anyone who is in good health will be virtually nothing.

The Finance Act has certainly brought some negative press to those with trusts, but there are still many advantages and reasons for using them. There are various types of trust that are designed to achieve IHT savings and that may be

appropriate in different scenarios. For example Discounted Gift Trusts can be used to give away large sums of capital without paying IHT and a Loan Trust can help people retain their capital but give away any investment growth.

Good financial planning in conjunction with a financial adviser is essential to assess the needs and opportunities, as well as ensure that any trusts are set up correctly. In many circumstances, a trust will still be the best and most tax-efficient way to look after family finances and ensure a safe financial future.

This article is based on Skandia's interpretation of Law and HM Revenue & Customs Practise as at September 2006. We believe that interpretation is correct, but cannot guarantee it. Tax relief and the tax treatment of investment funds may change.



An answer to stock market volatility?

Advisers looking for a low-risk investment product for clients have a new favourite. In an article recently published in Money Management, Nigel Brown, Senior Investment Consultant, looks at the Cautious Managed sector.

Bull markets do not last forever and the current one has run for over 35 months now. History shows that bulls tend to run for an average of 25 months – so what advice should be given to investors in a time of correction and growth slowdown?

Given that cash deposits are still unattractive to many clients, there is a need for a low risk proposition that will seek to achieve a better return than cash. Fortunately, in the last few years, investment managers have been constructing funds that will satisfy the current and indeed future needs of these clients – the Cautious Managed Fund.

If low risk clients are reluctant to take much risk with their capital, these funds are a positive step up from capital secure areas such as deposits and fixed rate bonds. They may hold up to 60% in equities as well as fixed interest securities and even property. As you would expect, there are many variants of this type of fund including multi-manager, distribution and global funds but all tend to follow the ethos of 'equity investment with caution' reasonably stringently.

If a fund held more than 60% of equities in its portfolio, it would stop being a lower risk proposition, but if it has less than 25% in equities, it would reduce its potential for capital growth. It really is a middle way between fixed interest (gilts and corporate bonds) and medium risk pure equity funds (UK equity and equity income).

There are those who would say that fixed interest securities prices have risen about as far as they can and as a result clients and their advisers may take the view: why buy an asset when it is expensive and has a relatively low yield?

It goes without saying that asset allocation and stock selection are key to performance and these are areas that a good fund manager should adequately manage. Cautious managed funds need a degree of security, which is offered by investment grade fixed interest securities, particularly as they have a low correlation with equity markets. Many fund managers are choosing high grade, short dated bonds to ensure that they are not stuck with low yielding assets.

Over the last five years, the cautious managed sector has outperformed the broader equity market by a substantial margin by blending investments in a defensive manner. Typically, cautious managed funds have a value-based investment style and often take a contrarian approach. One aspect of this approach is looking for shares that are cheaper than 'fair value', often under researched or perceived by growth managers as boring, with prices that are below their long term price average and with P/E ratios below the market average.

In summary, the Cautious Managed Fund will generally invest conservatively in a blend of equities and fixed interest securities that offer value for long-term, low risk investment, offering stable returns and a certain degree of protection from the downside of the stock market. The result is that these funds tend to be unspectacular in a rising stock market, but really come into their own in a falling stock market by limiting losses.

When it comes to fund selection, advisers have the arduous task of selecting the most appropriate fund for their clients' needs. One can take the route of a multi-manager fund to further increase the diversity of the investment, but ultimately selection should be based on the following: limiting equity exposure to between 35% and 60% for capital growth; limiting fixed interest exposure to between 25% and 40% for income; using a value based investment style; holding high grade bonds, short dated in the main; holding large and mid cap equities and potentially using some small caps; an active asset allocation between equities and fixed interest securities – this is essential; blending uncorrelated assets to aid protection on the downside; and limited exposure to a diverse mix of non UK equities. And of course, investors prefer an industry recognised fund manager with relevant experience, who is rated by S&P, Forsyth-OBSR and Citywire.



The advisory market has seen a lot of products come and go. Some, which seemed like a good idea at the time, ended up not being so good. But this sector is robust enough for the demand for cautious managed funds to remain for a long time to come. So what should be expected from these funds? The hope is to see annual returns for clients that will outperform both cash and inflation while cushioning the downside of the stock market.

In conclusion, I remember once hearing a very profound statement, which could be the perfect endorsement of the Cautious Managed Sector: "Be wary when the market is greedy and be greedy when the market is wary"

This is an extract from an article that was first published in the Financial Times Business Money Management Magazine, July 2006.

Innovation in the equity release market

Jon King is Managing Director of Hodge Equity Release and also holds the position of Chief Executive of SHIP. Here, he discusses recent developments and innovations in the Equity Release market.

Equity Release can be an emotive subject as withdrawing money from the family home does not come without its costs. However, for the right client, it can bring a new sense of freedom as holidays, property improvements and gifts that were previously unaffordable are made a reality. Each year more and more retirees are realising the potential previously locked in their home. Greater flexibility and reduced costs are the driving forces now making equity release a key strategic planning tool for anyone in or approaching retirement.

There are two main ways of releasing equity from the property. The first, and most popular route, is the Lifetime Mortgage. Similar to a regular home loan the Lifetime Mortgage's advantage is that there are no monthly repayments to be made. The interest is simply rolled up, added to the loan and only repaid after death or a move into long term care. The second option, the Home Reversion Scheme, involves selling part of the home for a discounted sum in exchange for a cash lump sum or income stream. The advantage with this scheme is that a guaranteed portion of the property will remain for beneficiaries to inherit.

Since their inception in the mid 60's there have been a number of false dawns within the Equity Release market. However, since the advent of Safe Home Income Plans (SHIP) in 1991, plans carrying the SHIP logo have offered core guarantees to clients that ensure the product has been scrutinised for its robustness.

The number of plans sold under the SHIP banner has increased dramatically in recent years from around 5,000 in 1999 to about 20,000 last year. As a result new lenders are being attracted to the market and more

SHIP approved plans ensure:

- ✓ Independent legal advice for all clients
- ✓ The right to live in your property for the rest of your life
- ✓ Freedom to move to a suitable alternative property without financial penalty
- ✓ A 'no negative equity guarantee' that ensures the debt will never exceed the value of the property

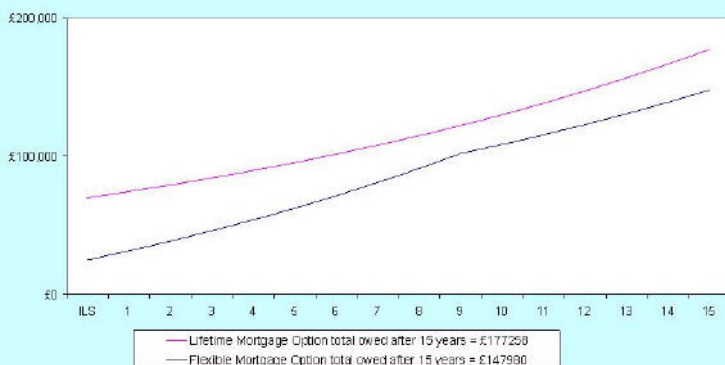


Innovative products are being introduced for their clients. One of the most recent developments has been the advent of the 'drawdown' scheme, which can reduce the cost of taking out an equity release scheme as well as increasing flexibility.

In essence the drawdown is a variation on the Lifetime Mortgage. However, rather than going for a one off capital release from the property clients can make withdrawals as and when monies are required. Because interest is only charged on capital that has been drawn down this should reduce the cost of borrowing over the course of the loan.

Table 1

The pink line depicts a client borrowing a **£70,000 lump sum** and the interest that would accrue over a 15 year term. The blue line shows a client making an initial **withdrawal of £25,000**, followed by a further **9 annual withdrawals of £5,000** (total £70,000).



The saving made in this example (with an interest rate of 6.21% p.a.) by using the drawdown method would be **£29,698**.

Source: Hodge Equity Release Flexible Mortgage Option & Lifetime Mortgage Option Sept 2006.

Whilst an increase in the number of different schemes in the market can only be welcomed as a good thing for the consumer, this example does highlight the need for good quality advice. Taking out the wrong plan can be hugely detrimental to the value of the estate at the point of repayment. An experienced adviser can make all the difference in weighing up the pros and cons of the wide variety of schemes that are available.

A good quality adviser will help their client through the decision to proceed with an equity release scheme. This may include 'downsizing', examining state benefit and/or local authority grant entitlement or considering an interest only mortgage. If, however, these options can't provide the required increase in income or capital, equity release could prove to be the right step to take. The market is expected to go from strength to strength over the next few years and with interest rates on Lifetime Mortgage products falling below the average standard variable rate, and with the increased flexibility they are delivering its easy to understand why.

The SHIP safety check:

- Do I have the right to live in my property for life?
- Do I have the right to move to an alternative property without penalty?
- Will I receive either a cash sum or regular income payments?

If you buy a home income or equity release plan through a SHIP member, you are guaranteed that the answer to these questions is **YES**.