

Pension Freedom

April 2014

As we all know, new freedoms for pensions were announced in the Budget 2014. I have been asked for guidance by several people and this article is to set out my understanding of the rules and how firms should look to participate in this area.

It is generally agreed that this freedom will give the opportunities for poor decision-making made for short-term benefits at the loss of longer term income. The consequence of this is likely to be a miss-selling scandal based on inappropriate advice and also the arrival of various organisations looking to “help” people to get their money out of their plans. You can bet that the Claims Management Companies will not be far behind; and may already be writing their adverts “have you been advised to get your money out of your pension?”

In view of all this, firms need to find a way of helping their clients, without putting their own business at risk from future comeback. Simply advising clients that a firm is not willing to undertake this business would not be in keeping with the Treating Customers Fairly principles. If the client wants to do this, it must be better customer service to help them, rather than send them to another adviser or worse to someone who give them advice with a poor outcome for the client, but profitable for the adviser.

I believe that this can be achieved by providing detailed information to the client before they make their decision. This should be provided as information rather than advice. It will be difficult not to stray into advice, but the documentation would be the provision of information.

First point of call for firms may be to check whether this type of business is likely to be covered by their Professional Indemnity insurers. If it is, are there any special terms or increased excess?

If a firm is to take part in this type of business, then it needs to ensure that it has a process to ensure that the business is undertaken in a consistent manner. The most important part is to clearly document how this business has been arranged.

I would recommend that a register is set up to record all enquiries received by the firm. The register should record which clients are involved, the amounts of their funds, the rationale for releasing the money and whether they proceeded.

I would recommend that a checklist is set up to ensure that all the relevant information is obtained to provide full detailed and clear information to the client.

The firm needs to obtain information about the pension plan. This information should include the value of the fund, any penalties that would be applied for taking out the fund. If there is a penalty, is there a point when the penalty would not be payable. A projection of the benefits that would be paid from the plan at Normal Retirement Date.

The firm should obtain annuity illustrations for Open Market Options from a third party portal eg Assureweb, iress or even MAS. For the sake of completeness, illustrations should also be prepared for enhanced annuities.

Then a letter should be provided to the client on the basis of a Statement of Demands and Needs rather than a suitability letter.

Most firms have made the decision to avoid execution only, insistent clients or even irrational insistent clients. Since this type of business may be quite regular, those classifications are likely to become over-used. Therefore, pension freedom should be a classification in its own right and counted separately. If the Statement of Demands and Needs is prepared carefully, it will provide information rather than advice.

So the example letter could look something like this.

Pension Freedom

You are aged 55 and have approached me to help you to withdraw your money from your pension fund. You are earning £20,000 and you are unlikely to retire until you reach age 68.

You have advised that you want to take the money built up in your pension plan in order to buy a new car, go on a holiday, undertake some home improvements and some money in the bank.

Your pension fund is worth £50,000 and has been set up for you to take your benefits at age 65. Your provider has advised that it can provide you with £12,500 Pension Commencement Lump Sum, currently tax free. The remainder will provide an annual income of £1,500 ($£37,500 \times 4\%$) for the rest of your life. There is no penalty for taking benefits at this time.

On checking the availability of annuities as Open Market Options an annual income of £1,875 ($£37,500 \times 5\%$) could be provided for the rest of your life. An enhanced annuity of £2,250 ($£37,500 \times 6\%$) per year could be provided, if your state of health qualifies you for enhanced terms.

Since current life expectations would be age 85, your annuities would pay £45,000, £57,750 and £67,500 respectively up to that age. If you survive longer, the annuities would be worth more. If you do not survive to age 85, then the values will be lower. Any annuity payment will be taxed at your marginal rate.

If you want the remaining £37,500 out of your fund now, it will be taxed in the following manner.

The higher rate tax threshold for 2015/6 is £42,285.

Therefore, the first £22,285 will be taxed at 20% with the remaining £15,215 taxed at 40%. The effect of this is as follows.

£22,285 x 20% = £4,457

£15,215 x 40% = £6,086

Total = £10,543

Therefore, from £37,500 you will be paid a net figure of £26,957

This figure could be increased by delaying the payment of the amount in the top rate tax bracket into the next tax year. This will reduce the tax payable on the £15,215 by £3,043.

This means that by taking all of your funds now, you will obtain £39,457 rather than £50,000.

Taking your benefits, now will mean that your future pension contributions will be limited to £10,000 per year rather than £40,000 that is currently allowed.

This letter is providing information to you regarding the value of your retirement plan and the value that you could obtain from the plan if you take your money now. No advice is being provided regarding the suitability or appropriateness of taking your benefits at this time.

Please remember that once this money has been taken from your plan, the ongoing benefits will not be available to you. If you want to build benefits, other than the State Pension in the future, you will need to make an alternative arrangements.

My fee for this information is £x. If you want me to help you with the paperwork, my fee will be £y to cover the time that will be required to complete the withdrawal. Due to the amount of people looking to release their funds, the providers may well need extra time to make your payment. Current guidance time from the providers is that you should allow some (3) months for your money to be made available.

It may well be that other information should be provided and you may not wish to set out the letter in this manner.

The files for this information should be treated the same as pension transfers and therefore should be retained indefinitely. It is important that the files are as complete as possible to show that the clients have received good quality, detailed information and preferably no evidence of advice.

It may well be that after releasing the money, the clients will come back for advice about investing some or all of the money. It is important that this is documented that the clients came back after the original decision to take the money out, rather than the withdrawal being made with a view to funding the investment. It is unlikely to be best advice to come out a of pension fund, with its internal tax advantages into an alternative investment type that may not have the same beneficial tax treatment.

I trust that this makes sense to you. If I have made any glaring errors or omissions, please advise me.