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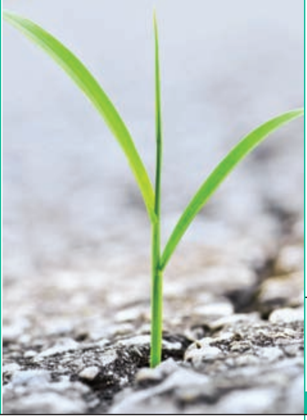
ChantreyVellacottDFK



Financial Services Briefing

Keeping you up to date with events in your sector.

Welcome

The recent launch of our Panel Firm approach to providing Financial Services to our clients has led to the production of our first Financial Services newsletter. There has become an increasing need, in uncertain financial times, to review, adapt and in some cases change arrangements that have been or need to be put in place in respect of pensions, insurance cover and mortgage policies.

With the recent Government budget and the draft Finance Bill 2011, we will see a number of changes from 6 April 2011 which will affect us all. This newsletter attempts to address the issues and suggests planning opportunities. The articles below have been written by our Panel Firms, details of which are included on the back of this newsletter. We extend our thanks to them and look forward to working with each and everyone of them in our respective offices across the South East.

Although we are not able to undertake FSA regulated financial services work ourselves, we can put you in touch with the right person at one of our Panel Firms who will be able to offer information and advice.

Full details of all our services are on our website www.cvdfk.com.

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New pension scheme from 6 April 2011

As a result of the draft of the Finance Bill 2011 major changes have been made to pensions that will affect all individuals in company pension schemes, as well as personal pension schemes. The legislation will amend pension tax relief rules and put an end to so-called compulsory annuitisation at age 75.

Key facts

1. Reduction in the Lifetime Allowance from £1.8m to £1.5m from 6 April 2012.
2. Reduction in the maximum annual pension contribution from £255,000 to £50,000 from 6 April 2011, any unused allowance can be carried forward for three years.
3. Removal of the anti-forestalling regulations from 6 April 2011, meaning tax relief on pension contributions will be provided at an individual's highest marginal rate, including relief at 50% for higher rate tax payers.
4. Removal of the so-called compulsory annuitisation at age 75.
5. Increased flexibility to take pension benefits out of a pension, including the ability to take 100% of the fund value out in any one year from age 55 onwards.
6. Changes to the treatment of payments from a pension scheme upon death.

Pension payments

The Government has confirmed that the lifetime allowance will reduce from £1.8m to £1.5m from 6 April 2012. Transitional measures are intended to help anyone who is either covered by existing protection or has been planning based around the £1.8m limit. It remains to be seen how much these measures will help.

The annual allowance will reduce to £50,000 for pension input periods ending in the 2011/2012 tax year. In the meantime the existing 'anti-forestalling' measures will continue to restrict higher rate tax relief for certain individuals from 22 April 2009 through to 5 April 2011.

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Unsecured Pensions and Alternatively Secured Pensions will effectively be removed.

Pension benefits upon death

Should an individual die before age 75, the tax position will depend upon if they have taken any benefits from the pension scheme. If no benefits have been taken, 100% of the value will be paid as a lump sum tax-free. If an income or tax-free cash has been taken, the lump sum will be subject to a 55% tax charge (which represents an increase from the current 35% charge).

Death post age 75, the lump sum will be taxed at 55% regardless of whether any benefits have been taken (which represents a reduction from the current 82% charge). No inheritance tax will be applied to payment of lump sums from pensions.

Pension withdrawal options

From age 55 individuals will be able to buy an annuity or access the new Drawdown Pension ('DP') at any time. Alternatively, they can choose not to take an income and defer a decision indefinitely.

DP will be available in two forms; 'Capped Drawdown' which will be very similar to the current Drawdown plans whereby withdrawals can be taken subject to Governments Actuary's Departments ('GAD') limits.

The maximum withdrawal has been reduced to 100% of GAD limits (at present the maximum is 120% of GAD limits). 'Flexible Drawdown' will allow accelerated, unlimited withdrawal of the pension fund as long as an individual can meet a Minimum Income Requirement ('MIR') although withdrawals will be subject to income tax at the individual's marginal rate. The MIR will be set at £20,000 per individual and will be based on a secure income stream such as state benefits, annuity payments and scheme pensions.

Unsecured Pensions and Alternatively Secured Pensions will effectively be removed. Pension commencement lump sums (previously known as Tax Free Cash lump sums) will remain tax free and they will also be available post age 75.

Planning opportunities

1. Higher earners restricted by anti-forestalling since April 2009, can carry forward the unused proportion of their £50,000 annual allowance from the three previous tax years. This will enable them to claim 50% tax relief on a pension contribution of £140,000 from April 2011 (assuming £20,000 contributions were paid in each of the previous three years).
2. Individuals can take advantage of the new drawdown rules to pass pension benefits to their dependants free of inheritance tax.
3. Depending on individual circumstances, there may be advantages in making a one off pension contribution within the current tax year, before the reduced annual allowance is implemented.

The Default Retirement Age ('DRA') is killed off on its 5th birthday

– what impact is there for employee benefits?

In 2006 the Government introduced age discrimination legislation, which included the Employment Equality (Age) Regulations. These regulations introduced a Default Retirement Age ('DRA') of 65 years, which is now going to be axed.

This does not mean that an employee has to stay in work beyond age 65, but it does make it unlawful to terminate the employment of an individual on the grounds of age any earlier than age 65. Employers are also required to have a process in place that enables any member of staff approaching age 65 to request an extension of employment beyond the DRA. An employer must consider these requests and providing they do not objectively justify a refusal, must confirm acceptance at least six months before the employee reaches the DRA.

So what is changing?

Following a ruling in the European Court of Justice in the Heyday case, supported by hundreds of tribunals across the UK and continual representation from pressure groups, the Coalition Government finally announced in July 2010 that the DRA will be scrapped from October 2011. Additionally from April 2011, no forced retirement notices can be issued, six months before the October change.

This means that employees will have the right to continue working regardless of age and can only be retired if an employer can objectively justify doing so. An example may be if a profession has a particular health and safety requirement, such as an airline pilot.

What impact does this have for employers?

Some employers feel that this will block the way for recruiting younger people from school, college or university. Others view this as a way of encouraging people with knowledge and experience to remain within a business, whilst reducing recruitment costs.

However putting recruitment and talent management to one side, there are other very real issues that employers need to consider around the provision of employee benefits.

The good news is that there will be a specific exemption for group risk insured benefits (income protection, life assurance and sickness and accident insurance, including private medical cover). This is to be welcomed since the increased cost of providing these benefits to over 65s could lead to employers scrapping these benefits altogether for all workers. This exemption will mean that employers can lawfully discriminate (depending on the nature of the benefit offered) against employees aged over 65 by not providing them with benefits which are available to the rest of the workforce.

For employers it is important to look carefully at the wording of the proposed exemption set out in the Regulations which are yet to be issued. It is of note that the Government refers to 'group risk' insurance benefits, so the provision of benefits outside this definition will not presumably fall within the exemption.

Action all employers must take:

1. Do you currently self-insure and is it now time to consider a fully insured arrangement?
2. Although defined contribution pensions create a very simple platform to allow extended contributions, those employers may still operating defined benefit schemes need to consider the rules, discriminatory issues and associated funding for those above age 65.
3. Most defined contribution pensions carry a default investment option, which more recently has been a 'Lifestyle' option. At a given period before the default retirement age, underlying investments shift to mitigate investment risk as the fund closes on the planned retirement age. This approach is no longer valid in light of this change.

Feathering the NEST for pensions

The Coalition Government sought an early review of NEST, the Central Pension Scheme for most employees without existing pension savings. The review was to consider whether the planned approach struck the right balance between the cost and benefits to individuals, employers and the taxpayer; particularly in light of current economic conditions.

The Government has now released the review team's findings and we have extracted the essential points that you should be aware of.

Employee contributions

The review states that the current earnings threshold at which an individual is automatically enrolled into a workplace pension is too low and could potentially damage the credibility of auto-enrolment. They therefore propose an increase in the earnings threshold aligned with the Income Tax threshold at £7,475 in 2011, with the intention for this to rise to £10,000. This is to avoid automatically enrolling those not earning enough to pay Income Tax.

The review also confirms that there should be no changes to age thresholds, which are between age 22 to State Pension Age or the contribution rate of 4%.

Employer contributions

The review goes on to say that all employers, regardless of size, are to be included in auto-enrolment and that NEST 'will provide a pensions scheme that will be appropriate to most small employers, and one which will be very easy for them to use'. The DWP should look to provide the maximum possible assurances to employers that they will not be held liable for their scheme choice, particularly if they opt for NEST or a stakeholder scheme to fulfil their new duties and the employer will be required to pay at least 3% of the relevant earnings.

Regulatory Changes

The review proposes two major regulatory changes:

1. Optional three month waiting period: Employers should be given an optional three month waiting period before automatically enrolling employees in a pension scheme.
2. A simplified certification process is being introduced: Any scheme that adheres to prescribed criteria on contribution rates, shared by employer/employees should be judged as meeting auto-enrolment and NEST requirements:.

NEST

Finally, the review calls for NEST to go ahead as planned but does state that whilst there should be no change to the NEST contributions cap in the short term, it should be removed once the staging in of all employers is complete and should be ratified by legislation in 2017.

It also mentions the need for an immediate review of Trust Based defined contribution schemes – in particular the ability to refund contributions to leavers within two years of joining. Opting out of NEST by an employee has to be done with NEST or your pension scheme provider. It cannot be dealt with by the employer.

Conclusion

The Coalition Government accepted the findings of the review and now employers must plan in advance as much as possible to accommodate the changes that are likely to take place in 2012.

Action all employers must take:

- consider the scheme structure including different scheme categories
- consider what waiting period will be applied from day one through to the three month maximum
- consider the contribution levels across the whole scheme
- ensure a suitable default fund is in place
- consider the staging date at which time you will be required to comply
- consider if you will include 'auto-escalation' of contributions
- consider the requirements and implications of the annual certification.

Shareholder Protection

…70% of UK businesses did not have any form of business protection in place…

The shareholders in limited companies and indeed, members of partnerships, often need protection against the impact that the death or critical illness of one of the shareholders or partners might have on the financial viability of a business.

If we look at an example, a company run by two directors with a 50% shareholding, both are married with children.

Unfortunately one of the directors is killed in an accident. The family are devastated but from a business point of view the company has lost a valuable partner in the business who contributed 50% to the running of the business. From the family point of view they still have a 50% share in the business which should give them some income. However they have no knowledge of the running of the business and still have the children to care for.

By losing a valuable director and having a new business partner that will not contribute to the running of the business, this could lead into difficulties and perhaps the company to cease trading.

If shareholder protection had been put in place, the scenario would have been very different. The protection policy would have paid the deceased family a lump sum of money equal to the value of company shares. The remaining director now has full control of the company and can look at ways of taking the company forward. This planning makes sense for both the business and the deceased's family.

Another situation could be that the director is diagnosed with a critical illness. He would still be entitled to draw an income from the business as he is a 50% shareholder but how long could the business survive on this basis. Once again a shareholder protection policy could help in this example.

Life assurance policies can either be written on a 'cross-life' basis, where each principal takes out a policy on each of the others, or by each principal on his or her own life, for the benefit of the others, under trust.

It is usual to use level term assurance for this purpose, possibly with a conversion or extension option. However, there is some merit in considering increasing term assurance, since the value of the business is likely to rise with time and introduce protection against inflation.

Within the context of shareholder protection, it is also worth considering that Key Man insurance can protect the business, and thus the financial interests of the shareholders, in the event of the death or long-term incapacity of certain key employees. These key employees may be the shareholder and directors or other key members of staff.

In 2005, Swiss Re estimated that 70% of UK businesses did not have any form of business protection in place, perhaps it is time for this to be addressed.

To Fix or Not To Fix

The answer is somewhere in the middle and very simple – review now and reserve a rate.

It has been widely reported that inflation has increased to 3.7% ('CPI'). Along with the increasing pressure for the Bank of England to increase the base rate from 0.5% this should have the seven million variable rate mortgage borrowers reviewing their mortgages.

Swap rates, which underpin fixed rate mortgages, have started to rise and mortgage rates look as though they have bottomed out. Lenders have been withdrawing products and are re-launching them at higher rates. For example, Skipton Building Society has withdrawn all their three and five-year fixed rate deals due to "unprecedented demand" and fears of rising interest rates.

Santander's economists are predicting Bank Base Rates to increase by 0.25% in May, another 0.25% in September and a further 0.25% in December. The swap rates market builds in "expected changes" so as the likelihood of a rising Bank Base Rate increases, fixed rates will become more expensive even before there is a change.

However, homeowners should not only consider interest rates but also the value of their home. If they have only 20% to 25% equity in their homes, falling house prices could make it more expensive to remortgage.

Catch 22

So here is the Catch 22 – sit tight on a low variable rate but be stuck with a bad deal as everyone panics when rates increase or fix now and potentially pay over the odds before they do.

The answer is somewhere in the middle and very simple – review now and reserve a rate. Depending on lender, a rate can be held for three to six months so you can switch when it's right to while having the peace of mind in knowing you are ahead of the game.

Specialist mortgage consultants are available for a complimentary review and may be able to reserve you a rate free of charge.

Who to Contact

For further information, please contact Mark Lamb, Debbie Ince or your usual Chantrey Vellacott DFK contact partner who would be pleased to refer you to the Panel Firm who they think is most appropriate to your circumstances.

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