

Protecting pension funds

In the earlier videos you may have looked at, we were looking at the new rules regarding how much can be funded in and the planning opportunities of doing so.

There are two other significant issues that arose from the changes announced by the Coalition Government which may be of equal importance to some of your clients.

The first of these is in relation to the announcement of the reduction in the Lifetime Allowance from £1.8m to £1.5m from the beginning of the next tax year. This is effectively a 20% reduction on fully tax relievable savings building up within the private pension arena.

The Coalition Government, however, recognised that these changes would have detrimental impact on some clients who previously had been expecting to save towards the Lifetime Allowance of £1.8m. As such, they have introduced another transitional form of protection to be known as Fixed Protection, for which clients will be able to register for by the end of this tax year.

Any of your clients who have already registered for Primary and Enhanced Protection under the earlier A-Day legislation would remain unaffected in terms of protecting the full capital value of pension rights against a Lifetime Allowance charge.

The new regime of Fixed Protection, however, will only protect clients from a Lifetime Allowance Charge based on a capital savings entitlement of £1.8m. In other words the known Lifetime Allowance before these changes to the threshold were announced by the Coalition Government.

In registering for this form of protection it could, for some clients with longer term views, avoid a 55% tax charge on up to £300,000 of pension capital. In addition, with a Lifetime Allowance of £1.8m

available clients will have a pension commencement lump sum available to them through Fixed Protection of up to £450,000 (25% of the protected Lifetime Allowance).

If Fixed Protection is not to apply the reduction in the Lifetime Allowance to £1.5m will see the pension commencement lump sum maximum reduce to £375,000 from 6 April 2012.

Fixed Protection does not require any minimum capital value in terms of the protection. However, in terms of the application, application Forms are likely to be available from HM Revenue & Customs sometime in August.

Clients, however, will only have until 5 April 2012 to register for this approval. There will be no evidence of benefit value required by HM Revenue & Customs and that is great from a client perspective and in terms of having to coordinate benefit valuation statements for clients. However, in registering for Fixed Protection clients will effectively opt out of future pension savings from 6 April 2012 as they will no longer be able to accrue relevant benefits in the private pension sector.

What does this mean from a client perspective? Well, in money purchase terms it's quite simple, no new money purchase contributions to any registered pension scheme can be paid on or after 6 April 2012 with the exception for clients who've contracted out through personal pensions, the receipt of continuing National Insurance Rebates on or after 6 April will not invalidate any Fixed Protection sought.

Similarly, contributions to provide continuing life assurance benefits for pre April 2006 death benefit arrangements will not invalidate forms of Fixed Protection.

Where clients do register for Fixed Protection, however, it is going to be

important from an adviser perspective to understand that issues may arise subsequently where clients wish to move the value of their benefits from one registered pension scheme to another. There will be certain rules that apply in terms of what is a permitted transfer that will enable Fixed Protection to continue to apply.

For money purchase arrangements any transfers can be made between money purchase UK registered pension schemes or to a QROPS without affecting Fixed Protection. Cash balance or defined benefit arrangements can be transferred to money purchase scheme without invalidating Fixed Protection.

Where benefits under a cash benefit or an existing defined benefit scheme are transferred to a scheme of a similar type, Fixed Protection will continue to remain available, but only where the transferring scheme is winding up or where there is a restructure of existing benefits due to the fact that the employer has sold part or all of the business and those benefits are being transferred to a new employer scheme.

In terms of membership of a defined benefit scheme and the definition of relevant benefit accrual, the test will be based on the increase in the annual benefit entitlement. For deferred pension entitlements, provided benefits increase by no more than the scheme definition of increase in annual rights as at 9 December 2010 no relevant accrual will have arisen and Fixed Protection will continue to apply.

For active members of defined benefit schemes who remain accruing pension rights, provided the increase in pension rights is no greater than the prevailing increases in the Consumer Prices Index, no relevant benefit accrual is deemed to have arisen and Fixed Protection will remain available.

In any input period, where the rights exceed the prevailing rate of increase in the Consumer Prices Index, then Fixed Protection will be invalidated and the client's test against the Lifetime Allowance will fall to the £1.5m threshold.

Due to the deadline of arriving at Fixed Protection and the decisions that clients may need to make there are a number of planning issues that will arise for yourselves as advisers and potentially a number of your clients.

2011/12, this current tax year, will for some, therefore, be the last available year for funding relievably contributions if Fixed Protection is to be registered. This could include use of the maximising the current years annual allowance, plus any unused annual allowance from the three previous pension input periods and when the clever combination of pension input period planning, advanced funding £50,000 annual allowance available for the 2012/13 tax year.

There may need to be a review of the underlying investment management of existing entitlements if Fixed Protection is to be registered. Would a client need to be so adventurous in the likely rates of return they will achieve on their existing investments, or could risk in part be taken out from that by taking a lower risk portfolio for future accrual to try and maintain the eventual benefits within the £1.8m threshold.

On a wider basis, where clients do register for Fixed Protection, in the longer term a review then needs to be made as to how they will build their future retirement provision using sources other than registered pension scheme funding. Within the overall view of this, clients will need to look at potential timescales before they wish to access their registered pension scheme savings. They will also need to take account of their anticipated future rates of return, as the combination of the two will dictate the likely risk of exceeding a £1.8m Lifetime Allowance threshold.

It is also worth pointing out that clients moving into capped income before age 75 will have two benefit crystallisation event tests. One at the time they access their tax-free cash and the other at age 75 or later annuity purchase, taking into account any growth on the capped income fund between the date of accessing the tax-free cash and age 75 or annuity purchase. This could create an excess against a Lifetime

Allowance and may need to be taken into account for planning.

I hope this brief run-through of these changes will highlight for you the thought processes of perhaps a number of clients where you may urgently need to review the decision making process they will need to make before the end of this tax year. It will open up some funding opportunities for you and may also open up opportunities for discussions with your professional connections of clients through those connections who could be impacted by this significant change that will come into effect from the beginning of the next tax year.

Thank you.

www.skandia.co.uk

Calls may be monitored and recorded for training purposes and to avoid misunderstandings.

Skandia provides you with access to its investment platform, known as Skandia Investment Solutions. Within this platform you can open an ISA and Collective Investment Account provided by Skandia MultiFUNDS Limited, a Collective Retirement Account and Collective Investment Bond provided by Skandia MultiFUNDS Assurance Limited and an Offshore Collective Investment Bond, distributed by Skandia MultiFUNDS Limited but provided by Old Mutual International (Guernsey) Limited.

Skandia Life Assurance Company Limited, Skandia MultiFUNDS Limited and Skandia MultiFUNDS Assurance Limited are registered in England & Wales under numbers 1363932, 1680071 and 4163431 respectively. Registered Office at Skandia House, Portland Terrace, Southampton SO14 7EJ, United Kingdom.

All companies are authorised and regulated by the Financial Services Authority with FSA register numbers 110462, 165359 and 207977. VAT number for all above companies is 386 1301 59.

Old Mutual International (Guernsey) Limited is regulated by the Guernsey Financial Services Commission and is licensed to write long-term business under the Insurance Business (Bailiwick of Guernsey) Law 2002. Registered number 2424. Registered Office at Albert House, South Esplanade, St Peter Port, Guernsey GY1 1AW, Channel Islands.

Skandia Investment Group is a trading name of Skandia Investment Management Limited. Skandia Investment Management Limited is registered in England & Wales under number 4227837. Registered Office at Skandia House, Portland Terrace, Southampton SO14 7EJ, United Kingdom. Authorised and regulated by the Financial Services Authority with FSA register number 208543, VAT number 386 1301 59.