financial focus issue 6

The specialist provider of holistic financial advice for medics and dentists

It's an *in*equitable life Henry!

Read on to find out if your With-profits policy is damaging your wealth...

There's a fair chance you've got some exposure to a With-profits fund whether it's an old mortgage endowment, a savings or pension policy or an investment. If you're not sure then it's certainly worth double checking because With-profits policies, whilst not having the last rites read, are in terminal decline.

This prognosis is mainly down to the very reasons that With-profits plans were such a long term success in the first place, "smoothing".

In essence smoothing aims to provide you with a less volatile return by holding back returns in times of plenty and using these *squirreled* funds to pay bonuses when investment hard times come knocking, or to pay the investor a final bonus at maturity.

To achieve this traditional With-profits funds consist of three elements; the sum assured (absolute minimum return), the annual bonus declaration (reversionary) which cannot be removed and the final bonus (terminal) which can be reduced by the fund management.

This worked very well for several decades as investors pooled together funds in their billions (some of this from misadvised mortgage endowment sales...), but at the turn of the millennium two events, UK stock market crash and the Equitable Life situation brought about a perfect storm.

Stock market decline

The sharp losses experienced during 2000, 2001 and 2002 put immense stress on With-profits funds. Smoothing should have been able to cope but in what can only be described as "keeping up with the Joneses" most With-profits funds had already been too reckless in paying annual bonuses in order to put them at the top of the performance charts. They had kept insufficient funds (terminal bonuses) in reserve to halt the slide in With-profits fund values. In many cases there was negligible terminal bonuses left at the depth of the stock market decline. This resulted in many fund managers enforcing exit penalties for those wishing to leave early but it also paved the way for the changed split between annual and final bonuses post 2003, which we are still living with today.

The Equitable Life saga

Against the above backdrop Equitable Life had over-promised many of its pensions policy holders and subsequently elected to renege on these guarantees. Understandably policy holders didn't quite see things the same way and the whole debacle ended up with the House of Lords directing Equitable Life to deliver its promises – it couldn't, it was essentially bankrupt and ceased accepting new business immediately, 10 years later most Equitable Life policy holders are still suffering – and it was contagious...

Perfect Storm

Add to falling returns, the inability to meet guarantees, exit penalties and preventative measures introduced by the fledgling Financial Services Authority. The FSA effectively insisted that With-profits providers ensure that they keep capital reserves sufficient to meet all their fund guarantees (sum assured and annual bonuses combined); Common sense? Yes. Damaging? Absolutely.

With the impact of new regulations With-profits funds positioned matching current and future liabilities first and then fund returns second. For some companies 'asset matching' pretty much equated to all of the With-profits fund being withdrawn from the stock market and put into low risk (and therefore low return) Gilts and Bonds. For one company, Standard Life, it meant them turning their back on being mutual (something it had defended staunchly in the era of carpet-baggers) so that it could raise capital to prop up its own With-profits funds and continue trading.

With Profits – the last decade, now and the future

The last decade has been tough for most investors, not just With-profits funds, but the liability matching requirements of With-profits has led to a seismic shift in how to 'smooth' returns. In 1999 Prudential (traditionally a major player when

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Should you leave the NHS pension scheme?

Chances are no you shouldn't, but whereas previously we could have said unequivocally that you should remain a member of the scheme there are tax changes ahead that remove that certainty.

The first of these changes is the reduction in the lifetime allowance (LTA) from £1,800,000 to £1,500,000 with effect from 6th April 2012. This reduction essentially puts us back where we were when the LTA was introduced in 2006, furthermore, the allowance won't be reviewed again until 2017. £1.5m still sounds a lot but that's the equivalent of a £65,000 NHS pension or £55,000 NHS pension and a personal pension fund of £250,000.

You may have reviewed your personal LTA when they were first introduced and found yourself comfortably under the threshold and, naturally, decided that this wasn't an issue to concern you. However, with cumulative inflation from 2006 standing at 19% (1/4/06 to 1/4/11) and even if the long-term target of 2% is achieved until 2017 then retail price inflation will have hit 35% over the 11 year period, but the LTA will still be at the same level.

Fiscal drag has been a sneaky way of increasing tax take for a long time; lower than inflation increases to other allowances such as IHT thresholds, personal tax allowances and stamp duty thresholds have effectively raised tax take for decades. It would appear that pensions are next to feel the erosive power of inflation as 11 years of inflation will have come and gone before the LTA is increased above its starting level, if indeed it is raised at the 2017 budget.

What does this mean to you, and why should it challenge your NHS Pension Scheme membership?

The end result is that more doctors and dentists will exceed the LTA and therefore will face a tax charge of 55% on the excess pension fund at retirement – worse still is that you can only take evasive action now and you have to act quickly.

What protection do I have?

When the LTA was initially introduced HMRC provided protection to existing members who had, or were likely, to exceed the threshold. This option expired in 2009 and is not available to new applicants. HMRC are to afford protection again, but the new levels of protection exclude new scheme benefits being accrued and therefore remaining an active member of the NHS pension scheme isn't allowable.

The new protection, "fixed protection", essentially fixes the LTA at £1,8m until such a time that the underlying LTA is revised to a higher level, this will not be earlier than 2017 as previously mentioned.

This could be the difference between maintaining a pension fund of up to £1.8m or paying a tax charge of 55% on the difference between £1.8m and £1.5m (£165,000). There will be some instances whereby paying the tax charge is the best option, but many more cases where opting out of future accruals (by opting out of the scheme) represents the best course of action.

Indecision isn't an option

Unlike the last raft of protection options, this time you will need to have decided in good time to effect protection before the new LTA rules are introduced. In reality you will need to have considered, decided and actioned the changes before the end of this tax year as one days membership to the NHS pension scheme beyond the next tax year will render any protection invalid.

MedDen pride ourselves on understanding the NHS pension scheme and how changes to pension legislation impact our clients; if you would like to review your own position please contact your MedDen adviser or alternatively you can email enquiries@meddenifa.com

Should I stay?

Dr Jones – 54 year old practitioner with 'total uprated earnings' of £3.65m and a personal pension valued at £250,000.

Dr Jones should remain in the NHS Pension Scheme as currently he is only using £1.4m of his Life Time Allowance. However, prudent planning is essential to minimise any tax he would face should his LTA exceed £1.5m in the next 5 years.

Or should I go now?

Mr Smith – 58 year old consultant with Gold CEA, 35 years' service and a personal pension valued at £100,000.

Mr Smith should leave the NHS Pension Scheme as currently he has amassed a £1.75m Life Time Allowance, being a member of the scheme after 5th April 2012 will result in £250,000 of his pensions being subject to a 55% excess taxation charge.

It's an *in*equitable life Henry! - continued from page 1

it comes to With-profits) achieved fund returns of 7.5% on its traditional With-profits fund – of this it distributed 6.25% as an annual (guaranteed) bonus and retained 1.25% for future smoothing and final bonuses (not guaranteed). 12 years later a return of 6.75% has resulted in a 3% annual bonus declaration with the remaining 3.75% (less expenses) for future smoothing, final bonuses and liability matching.

Naturally, it's dangerous to speculate about the future, but the above snapshot of the With-profits market doesn't inspire confidence in a reversal of fortunes for With-profits funds.

As such, any **existing policies** in **With-profits** funds should be **reviewed** to ensure that it is still fit for purpose, and perhaps wherever possible an exit should be considered based upon the costs of exiting versus any potential replacement contract. At **MedDen** we can offer a **With-profits review and analysis** with a view to keeping you fully informed of the quality of your existing contracts, after all lets not tar all With-profits policies with the same brush, and where appropriate recommending a more suitable solution.

Finally, one size doesn't fit all...

Regardless of the structure of your With-profits funds, or any other pooled investment, you need to be aware of the asset allocation (and therefore the investment risk) of the underlying investment fund. If you are in the midst of accruing your savings then it is more likely that you would entertain more risk than somebody at the point of encashing their life savings; likewise, savings for retirement that is 20 years away would likely have a higher equity exposure than when you are only 2 years from retirement. Using the Prudential With-profits fund as an example the asset allocation in 2011 was 49% Fixed Interest, 22% UK Equities, 10% Overseas Equities and 13% Property (6% others) regardless of what the investor is saving for or the timescales you get the same solution. And that, simply, doesn't provide the best solution for all.

NOTICE BOARD

Pensions for employees

The National Employment Savings Trust goes live from October 2012 (for very large companies). For most of our clients with employees (including spouses employed) then March 2014 is the date that you will need to have in place your own NEST scheme for your employees.

NEST will require a minimum contribution of 8% of 'band earnings' (currently £5,715 - £38,000) to be paid into a company pension scheme. The 8% is broken down as 3% from the employer, 4% from the employee and 1% tax relief.

If you are an employer you need to be aware of how this will impact upon your business – call MedDen today to discuss.

We would like to advise you of our new office address "MedDen House, 3 Hanover Avenue, Leeds LS3 1BG". All our other contact details remain unchanged.

One thing that our office move has reawaken in our consciousness is the ability to put business property into your pension, if you would like to assess whether this would work for you, or would simply like more information just contact us.

As Tax rates rise...
...don't forget your tax free options

Luncheon Vouchers – 15p per day tax free!

Drink 'Black Beer' there's no duty, although at 8.5% ABV we wouldn't recommend you do!

Tax & NI free breakfasts for cyclists on designated 'cycle-to-work' day, making you healthier and wealthier?

With all the recent talk of million, billions and trillions we thought a little perspective on these is in order. A million is straight forward, a billion is 1,000 million (it used to be a million, million on these shores) and a trillion is a million, million (previously a million, million, million!).

So a trillion is 1,000,000,000,000 – we promised perspective – a trillion seconds ago it was 29,677 BC. Some 'experts' estimate that the total liability of all UK Public Sector Pensions stand at £1 trillion, hence all the changes to the UK's Public Sector Pensions (that's not to say the changes are fair).

It is important to remember that the value of investments, and the income from them, can go down as well as up and is not guaranteed and that you, the investor, may not get back the amount originally invested.
This publication is for guidance only and individual financial advice should also be sought before making any financial decision.
References to tax are based upon our understanding of tax law and HMRC practice as at December 2011 and are subject to change, tax relief is based upon individual circumstances.
Think carefully before securing other debts against your home. Your home may be repossessed if you do not keep up repayments on your mortgage.

DENTAL SPECIFIC

Associates, incorporation and the NHS Pension Scheme

Many of the nation's dentists have incorporated their business since the change in the Dentists' Act in 2006, hoping to reduce their tax bills. Further tax increases, such as the introduction of a 50% tax band and the removal of the personal tax allowance for those earning over £100,000, has seen the number of incorporations increase.

Most are attracted by the rates of Corporation Tax which are lower than the tax rates levied on the individual. You must remember though that you will still have to pay personal tax on salary and dividends drawn out the limited company.

Worryingly, we have found that some accountants have not been telling the full story. Following incorporation the superannuation for a provider (GDS/PDS contractor) remains unchanged. However, if a performer (an associate) incorporates they cannot be a member of the NHS Pension Scheme because their rules do not allow for this.

In the NHS' own words: *Whilst it is permitted for a GDS (or PDS contractor) to incorporate and for the providers (i.e. general dental practioner shareholders) to remain in the NHS Pension Scheme there are no provisions for a performer (i.e. associate) to remain in the scheme if they set themselves up as a limited company or similar. When the associate incorporates the contractual arrangements change in pension terms. The GDS (or PDS) contractor sub-contracts with a company, rather than contracts with an individual, and the company sends the associate to perform the work. Under the NHS Pension Scheme regulations the limited company created by the associate is not recognised as a type 1 dental practioner.'*

Many dentists appear to be unaware of this issue, and we have found that some who are incorporated continue to contribute to the scheme even though they will be unable to claim the benefit.

Associates who have already incorporated should seek advice on their pension situation from their adviser and those who are considering incorporation should question their accountant fully on the implications of doing so.

Who else is covered by your Critical Illness Cover policy?

Many clients will already have valuable critical illness cover and be aware of what would give rise to a claim. However, it may come as a surprise to learn that you might not be the only person protected by the policy...

Most critical illness policies bought in the last decade will provide cover for the policyholder's children. Whilst you would never want your children's health to falter, should it do so then your critical illness policy may provide you with some financial support.

The numbers of conditions covered are increasing.

Of late, in a market that is continuously evolving, critical illness providers have added cover for more conditions. The end result is that some providers boast of covering 161 conditions. From this list 27 conditions have individually accounted for less than 0.2% of total claims.

Of all of the conditions, MedDen prioritise the catch-all of 'total permanent disability' whereby any condition that leaves you permanently incapable of carrying out your own occupation will give rise to a payment. Whilst not wishing to measure conditions against each other, the chances of not being able to follow your speciality is likely to have a more damaging impact upon your finances than the majority of all other conditions covered.