SOVEREIGN
SovereignGroup.com

Pensions Update

Issue 5 (February 2014)

Sovereign's pensions newsletter

Annuities under fire

UK pensions minister Steve Webb has sparked renewed debate on the practice of purchasing an annuity at retirement. Annuities convert a lump sum in a pension scheme into an income that is paid for the remainder of the member's life. Over 400,000 retirees still purchase an irreversible annuity each year, according to "The Sunday Telegraph", but the value of the annuity is closely linked to interest rates at time of purchase. As a result, with interest rates at historical lows in recent years, many pensioners have found themselves locked in to low retirement incomes.

Webb has suggested that the current system be changed to allow retirees to switch annuity provider after the pension has commenced. This would enable retirees to shop around for the best-paying policies if they felt they were getting a poor deal.

Perhaps unsurprisingly these proposals have not been well received by the insurers who make up the annuity market. Market commentators have also suggested that the proposal is unworkable because the costs of administering the annuity transfer and calculating transfer values would lead to a reduction in annuity rates across the board.

Other potential solutions include increased transparency. Only one annuity provider currently discloses its profit margins on annuity business – and that was a staggering 20% back in 2011. The UK's Financial Conduct Authority (FCA) is due to publish the results of a thematic review of the annuity market in the coming weeks and this could lead to changes.

In the meantime it is vital that any client at the point of retirement is fully aware of their options. All Sovereign QROPS products offer capped drawdown as an alternative to annuity purchase. This allows the member to keep control of the capital and importantly, they are not locked in to interest rates at commencement.

Sovereign launches Centaurus Lite QROPS

Sovereign is delighted to announce the launch of its new low cost Malta QROPS for pension pots of less than £100,000. Centaurus Lite is priced at just €400 for establishment and the annual fee is €600. Investment options within the plan are flexible including access to most offshore bonds and platforms. The product adds to the existing Malta range, which includes the full Centaurus QROPS and the Rinella Malta QNUPS. Sovereign now offers an unrivalled six QROPS with full and "lite" options also available in Gibraltar and Isle of Man. All product literature is available on our website **www.SovereignGroup.com** or from your local Sovereign representative.

The Sovereign Art Foundation

The image at the top of this newsletter: "Child in Red" by Haris Purnomo, 2007 Sovereign Asian Art Prize Public Vote Winner
A charity raising money to help disadvantaged children using the arts as rehabilitation, education and therapy. www.SovereignArtFoundation.com

Corporate Pension Schemes

In addition to its leading QROPS and QNUPS range, Sovereign has extensive experience in structuring corporate pension schemes and employee benefit trusts (EBTs). Designed on a bespoke basis, these arrangements can discharge local employer obligations as well as providing an attractive addition to any remuneration package.

Increased Gilt yields could make drawdown review worthwhile

The yield on 15-year UK gilts has risen steadily over recent months to its current level of around 3.25%. This represents a 1% increase since April 2013, mainly due to improved economic sentiment and a relaxation of the UK government's quantitative easing programme. The 15-year gilt yield is important because it is used, in conjunction with the UK Government Actuary's Department (GAD) tables, to determine the maximum annual pension an individual may take under a capped drawdown pension arrangement.

Although this increase in yields may not appear spectacular, the impact on the annual pension can be significant. Based on the rates in April last year, an individual aged 55 with a pension pot of £200,000 would, after taking their lump sum, have a maximum annual capped drawdown pension of £10,320. For a 55-year old commencing drawdown today, however, the same pension pot would provide a maximum pension of £11,760.

It should be remembered that the maximum capped drawdown pension is reviewed every three years and then annually from age 75. A pension scheme member may, where it is beneficial, request a review of their maximum pension annually on the anniversary date of its commencement.

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Defined Benefit Pensions - Managing Expectations

It is no secret that defined benefit pensions are, to coin a phrase, a dying breed. A recent survey by the National Association of Pension Funds (NAPF) found that only 13% of UK defined benefit schemes were open to new members last year compared to 43% of schemes in 2005, demonstrating the changing shape of UK workplace pensions.

The shift from defined benefit pensions has been accelerated by the significantly increased cost of purchasing gilts and high-grade bonds to cover liabilities. To reduce expenses employers have a number of options. These include structural changes such as increasing the retirement age, closure to new membership and closure to future accrual for existing members. Most employers have opted for an outright switch to defined contribution plans.

Public sector employees are not immune from these changes. The UK government has announced plans to switch employees such as teachers, NHS staff and local government workers to a scheme based on career average earnings from 2015. The retirement age will also be aligned with state pension age (set to increase to 68 years) and the employee will have to pay more in contributions each year.

Benefits in respect of past service are usually sheltered from these changes. However any expatriate with UK pension benefits should review their situation on a regular basis. More information is available via the Sovereign / PenTech IFAS portal **www.pentech.im/ifas/**

UK Lifetime Allowance Protection

With effect from 6 April 2014 the Lifetime Allowance (LTA) for UK tax-relieved pensions savings will be cut to £1.25 million. This follows a previous reduction from £1.8m to £1.5m in April 2012. When tested against the LTA, the tax charge on any excess is 55% if drawn as a lump sum and 25% if drawn as a pension (the pension will also be taxed).

Various “benefit crystallisation events” can trigger an LTA test. These include: death before drawdown; the commencement of retirement benefits; attaining age 75; and transferring to a QROPS.

Any individuals likely to be affected may apply to HMRC for protection, which is offered in two forms:

- Fixed Protection 2014 – This allows the individual to protect their current LTA entitlement of £1.5m. However, any future contributions to a UK-registered pension scheme will invalidate the protection. The deadline for applications is 5 April 2014
- Individual Protection 2014 – The individual may apply for a personal LTA equivalent to the value of their pension savings on 5 April 2014, provided that it does not exceed £1.5m. Future contributions are allowed and applications may be made from 6 April 2014.

Monies transferred to a QROPS are not restricted by the LTA and future growth is unlimited. There will be no charge at the point of transfer to the QROPS provided benefits are within the LTA. If the proposed transfer is above the LTA, the UK tax charge at the point of transfer is restricted to 25%.

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