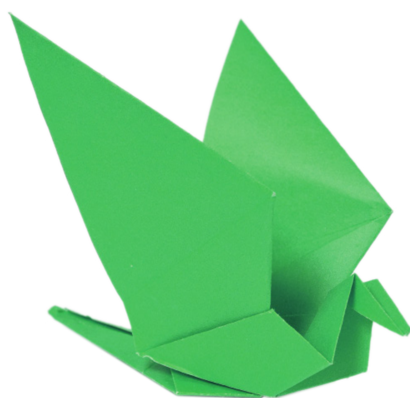
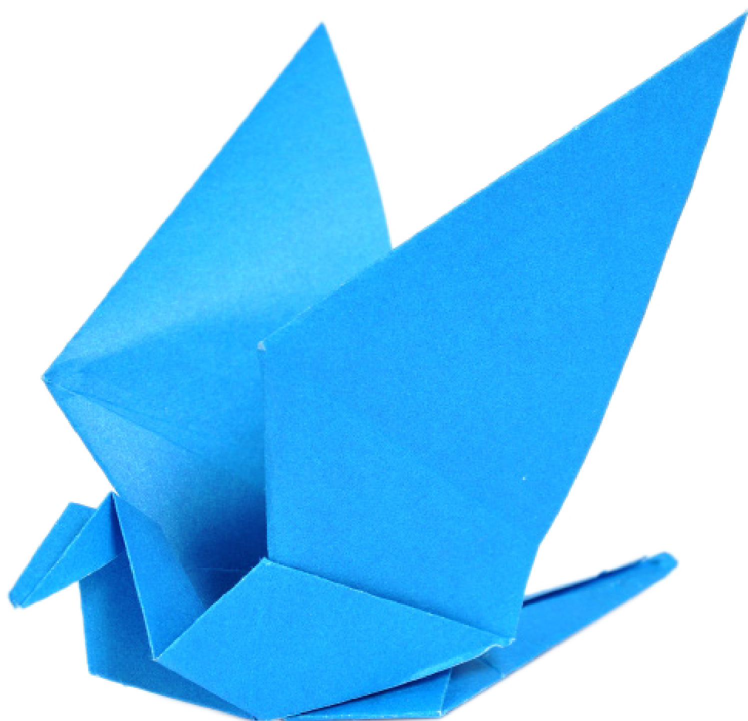
eValue
Investment Solutions

How to...
Help your clients use their pensions freedom wisely

How To Guide

Introduction

The new pension freedoms that came into effect in April 2015, may, at first, seem like a very attractive prospect. However, these freedoms, which are available to anyone aged 55 or over with a Defined Contribution (DC) pension scheme, could come at a high price if poor or ill-informed investment decisions are made at crucial moments.

In fact, the stakes are such that if your clients make the wrong decision, they could run out of money after just a few years, or maybe even straight away if they decide to blow the lot. Your clients, therefore, need to know that the decisions they make, when they retire, are irreversible and will affect the quality of their lives for many years to come.

So, what can you do to help? Well, it will no doubt be a big challenge but here's a look at how to get the right focus as the new pensions regime comes into effect.

You will need

- Clear descriptions of the key pension changes which are easy for your clients to understand;
- Comprehensive understanding of your client's timescales, financial circumstances and investment goals;
- Realistic financial forecasts;
- Explanations of the tax implications of all available options at retirement.

How to get started

Be clear on the key issues

Until now, one of the greatest concerns people have had about putting their savings into a pension scheme is that the money being invested will be tied up until retirement. With that restriction being removed from April 2015, advisers should be thinking differently about pensions and presenting them to their clients as a much more flexible investment option.

The key changes being introduced from April 2015 include:

- Members of DC pension schemes, aged 55 or over, will no longer be required to buy an annuity but will be able to take their entire pension savings as a lump sum and spend or invest it as they like;
- Individuals can withdraw up to 25% of their pension pot tax free, as now, but the balance will be subject to income tax at their marginal rate;

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- The 55% death tax for under-75s is being abolished. If a person dies aged 75 or over, their beneficiaries will pay their marginal rate of income tax on any money withdrawn from the fund, or 45% if the funds are taken as a lump sum. From April 2016, lump sum payments will be taxed at the beneficiary's marginal rate of income tax.
- Everyone retiring with a DC pension will be entitled to free, individual and impartial guidance. This "guidance guarantee" will initially be delivered by the Citizen's Advice Bureau and The Pensions Advisory Service.
- There will be no cap on the amount of money that savers can withdraw under income drawdown arrangements.

Establish your clients' attitudes and priorities

As has always been the case, the job of financial advisers is to help individual clients to understand their options and make informed investment decisions; the ultimate aim being to support their clients in making the best possible choices. This can be done by establishing the investment objectives and time-frames which your clients are focused on, or should be considering, when it comes to their retirement goals and the state of their pension savings.

Below is our checklist for getting it right and for ensuring that the most appropriate questions are asked during client fact-finding discussions:

- How much income does your client need to cover their essential everyday needs?
- How much income do they need to have a comfortable retirement?
- What are their lump sum requirements?
- How much risk are they prepared to take with their investments?
- What are the benefits and drawbacks of each option?
- How long are they likely to live and how can you ensure that they do not run out of money?
- What are the tax implications for them?

Provide realistic financial forecasts

With the introduction of the new pension freedoms, it is more important than ever that retirement forecasts are as realistic as possible. This will not only help your clients to evaluate the potential outcomes from different financial strategies but will enable them to make informed investment decisions which will have a direct impact on their future wealth and lifestyle.

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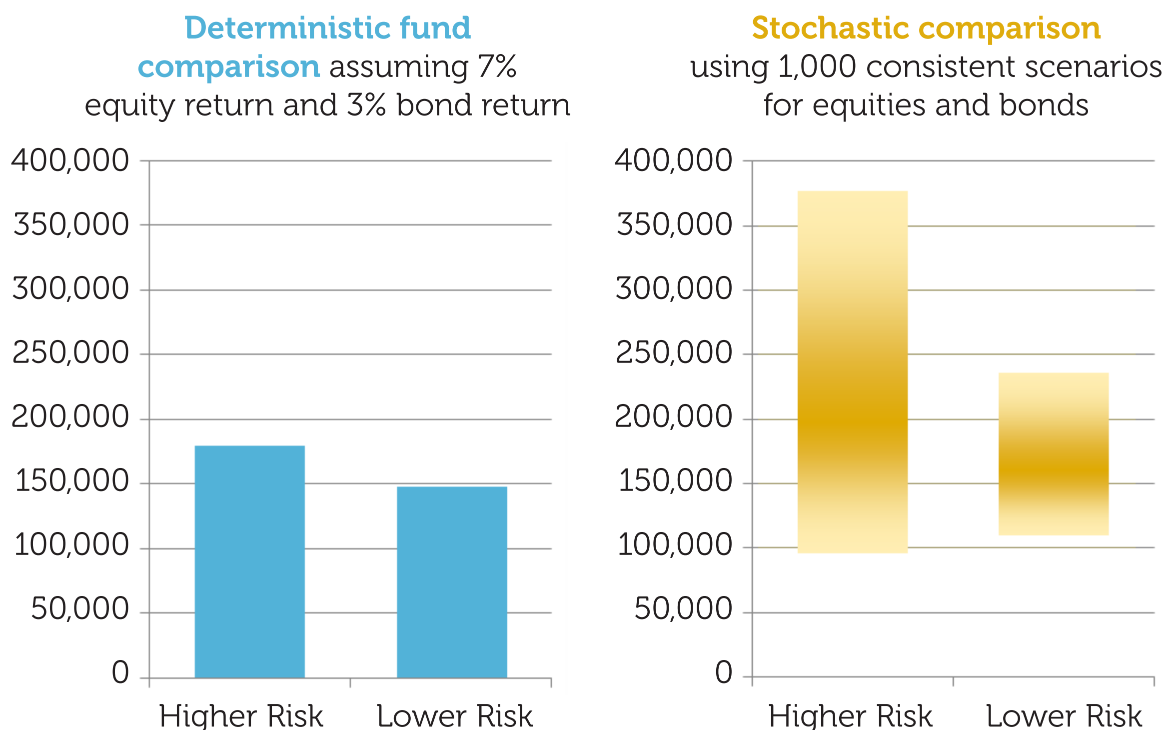
Deterministic forecasts estimate the amount that an individual will have in their retirement pot, at their anticipated retirement age, by using fixed rate assumptions about the investment returns which might be achieved on their retirement savings. Unfortunately, such forecasts do not include any concept of the risk or likelihood of a particular outcome occurring. Deterministic forecasts also assume that investment returns will be exactly the same every year even though the timing of high or low returns can make a significant difference to the final fund value.

Stochastic forecasts, on the other hand, use many different scenarios to give a range of answers rather than just a single figure. Stochastic simply means that the forecast considers more than one possible outcome and enables the likelihood of different scenarios to be assessed. This type of forecasting is the basis for of all eValue's financial planning solutions.



Point out the tax implications of the different choices at retirement

For many people, the idea of accessing the entirety of their pension fund before retirement age will sound great and should offer a good deal of financial flexibility. But, it is imperative that before any final decision is made, the tax implications of the various choices are taken into account since this could be crucial in determining outcomes.

Individuals who have, in the past, been used to simply paying the basic rate of income tax might not realise that dipping into their pension pot during retirement could result in them ending up in a higher rate income tax bracket leading to unwelcome, increased tax bills.

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Under certain circumstances, tax could potentially erase half of a client's pension plan. It is therefore, vital to ensure that any plans you recommend to your clients consider the amount of tax payable. In some situations, it will be right for the client to take their pension as a lump sum, maybe to clear a mortgage debt for example, but it may not be the most suitable choice in every case. It is also important to point out to clients that pension plans remain one of the most tax efficient savings plans in the UK. Tax relief, coupled with virtually tax free growth, together with the flexibility in benefits when they retire, make pensions a very attractive savings options for many long term investors.

Don't forget about annuities

What of annuities? In reality, these expanded pension freedoms are unlikely to spell the end of the road for annuities. Their popularity might be dented but, if your client needs a guaranteed income throughout their retirement, then annuities remain a good, viable option.

A client could live, on average, a further 19 years after their retirement so providing a sustainable future income for them has to be a key goal and annuities should certainly enter the equation as a potentially optimal option.

Greater trust and added responsibility

The government has taken a bold step in effectively saying to the British public at large: "We trust you with your pension." But, as thousands of Britons prepare to take far greater responsibility for their own financial futures, it will become more important than ever that clients receive the right guidance and professional advice to help them make the most of this new flexibility and the changes that are almost upon us.

If you like this How to Guide, why not explore eValue's Pensions Freedom Solutions at evalueis.com.

If there is a subject you'd like to know more about, then we'd love to hear from you. Please email us directly.

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