

Financial Planning During Volatile Markets

Volatile stockmarkets cause many to question the wisdom of investing in traditional financial products. Although pension plans, ISAs and collective investment funds are generally long term investments, it is normally possible to invest in funds that are not linked to the performance of equity markets; a switch to more conventional equity based funds can be made once markets become more settled.

A higher rate taxpayer with cash on deposit at 3.75% gross would receive just 2.25% after tax. Making a pension contribution improves the return considerably:

	£10,000 on deposit	£16,667 in a pension plan (£10,000 after 40% income tax relief)
Gross interest rate	3.75%	3.75%
Gross interest	£375	£625
Interest after 40% income tax	£225	£625

Cash may be held within ISAs provided there is an intention to invest in equities or fixed interest securities although, unlike a pension fund, any deposit interest earned is taxable at 20%. Other investment products, such as single premium bonds, also offer deposit based funds which may be held pending decisions about longer term investments.

Remember that:

- Personal pension contribution allowances can no longer be carried forward and must be paid by the 31 January following the end of the tax year to which they relate (so contributions for the year ended 5 April 2002 must be paid by 31 January 2003);
- Partners in practice can earn tax free interest inside their pension funds from the date that a contribution is paid. Delaying payment means that any interest accrues to the partnership and is taxable;
- Employees may be able to sacrifice salary or bonuses and receive tax relief of up to 60% if their employer pays a pension contribution and agrees to add in the saving in employer's National Insurance Contributions;
- ISA contributions must be paid in the tax year to which they relate.

Equitable Life

Equitable's latest denial that it is insolvent or about to appoint an administrator and the £75 million mis-selling compensation which may be paid by the With Profits fund have led to renewed concerns over the future of the Society.

Many policyholders have already left the With Profits fund but remain in unit linked funds which are reassured with Halifax Life.

Halifax Life may settle claims directly with policyholders but at present are doing so via Equitable Life. There is, in our view, a small risk of financial loss and/or delay should Equitable declare itself insolvent after it receives a claims payment from Halifax but before passing it on to the claimant.

Those concerned about this matter or retained With Profits fund holdings should seek advice.

Autumn Seminars

Autumn seminars on "Maximising your pension fund benefits" were held at Downing College, Cambridge in September and will be held at Ironmongers Hall on October 17 and 31 and in the Manchester Conference Centre on November 20 and 25. Please contact us to reserve your place.

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Regulated by the Financial Services Authority.

This note is for general guidance only and represents our current understanding of law and Inland Revenue practice as at October 2002. We cannot assume legal liability for any errors or omissions and detailed advice should be taken before entering into any transaction. The value of investments and any income from them can go down as well as up and you may not get back the full amount you invested. Levels and bases of, and reliefs from, taxation are those currently applying but are subject to change and their value depends on the individual circumstances of the investor. For income drawdown policies, it should be noted that: high income withdrawals may not be sustainable during the deferral period; taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of income is being taken - this could result in a lower income when the annuity is eventually purchased; annuity rates may be at a worse level when annuity purchase takes place and a certain investment return is required simply to "keep pace" with an annuity, because a pension withdrawal fund does not receive a benefit from the early death of other pensioners (mortality drag) as does an annuity.

Life Offices Under Pressure - The End of With Profits?

Life offices continue to feel the strain of falling equity markets. Even Standard Life has been forced to cut policy values by an average of 10%, with a further 10% average reduction (market value adjuster - "MVA") for policyholders who leave the With Profits fund early.

The MVA is designed to protect the position of investors who remain in the fund. Pension policyholders aged 50 or over may be able to avoid the MVA by taking pension benefits.

Clients have benefited in this bear market from the smoothing effect used in with profits funds. Where policy values have been cut, the reductions have generally been less than if clients had been directly exposed to the underlying equities which represent a substantial part of with profits funds. This benefit to clients has been at the expense of life office reserves, which have been depleted.

Should stockmarkets continue to fall, further cuts in policy values must be expected. If and when markets recover, the future growth in with profits policies may be inhibited whilst insurers replenish their reserves.

Meanwhile, the regulators have instigated several reviews of the life insurance and pensions industry. Ron Sandler's recommendations for with profits funds, if implemented, will result in more investors being able to work out for themselves whether their policies are worth more or less than the underlying asset value from time to time. It is difficult to see how far with profits policies will be able to maintain market smoothing in these circumstances.

These factors combine to suggest that clients should consider reducing their exposure to with profits funds. However, many policies contain valuable guarantees and so advice needs to be taken.

Cash Commutation under Threat?

Articles in the press have suggested that the Chancellor is considering either removing the ability to take part of your pension fund in cash, or taxing the cash element as income.

Logically any change should only apply in relation to contributions made after the change is announced. However, where the intention is to take benefits in the next 2/3 years or where a policyholder is aged 70 or over, and cash commutation is an important element in future tax planning, taking some or all benefits now should be considered.

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