NLP Financial Management

NLPFM news

News and views from NLP Financial Management

Compulsory Pension Schemes

The government has introduced legislation making it compulsory for employers to provide a qualifying pension for all their eligible employees. Known as Auto-Enrolment, the scheme began in October 2012 for the largest employers and will continue to be rolled out for smaller employers over the next 5 years. This means all eligible workers will be automatically enrolled into their employer's qualifying pension scheme without any active decision on their part.

Effect on Employers

Each company will be given 12 months' notice of their 'staging date'. This is the date when the employer's obligations with regard to Auto-Enrolment will start. This may sound like ample time, but it is likely that setting up a new scheme or ensuring an existing scheme is compliant, could take 6-12 months.

To help employers through the maze of pension paperwork, there are several centralised pension schemes available, NEST (the National Employment Savings Trust), being the most widely publicised. NEST has been set up to provide a relatively straightforward scheme for employers to offer their employees. However, whilst this scheme might receive the most publicity, NEST will provide employers with little direct assistance and crucially, no advice. The responsibility for establishing scheme eligibility criteria is the employer's alone, leaving them exposed to significant fines for non-compliance (between £50 and £10,000 per day).

One alternative to the centrally provided schemes is a traditional group pension arrangement. Established in conjunction with a large insurance company, employers can call on the expertise of both an IFA and pension provider to help them through the set up and management process. Specialist software has been devised covering all aspects of the process, to make it as simple as possible for employers to establish and maintain a compliant scheme.

Employees will have the option to 'opt out' of the company scheme, but it is illegal for employers to encourage employees to do so. Therefore it is likely that where employees have not previously been offered a company pension, take up will be high. Contribution levels have been publicised as 8% of an employee's eligible earnings (3% employer, 5% employee). However, these are only the

continued »

Inside this Issue

This newsletter is for general information only and should not be construed as a personal recommendation of any investment or service. We suggest that you contact us for independent financial advice so that we can determine the suitability of investments and services on an individual basis.

Please remember that past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and investors may not get back the amount they originally invested. Changes in rates of exchange may also cause the value of investments to go up or down. Tax treatment depends on the individual circumstances and may be subject to change in the future. The Financial Services Authority does not regulate advice on taxation or trusts.

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headline rates and depending on how an employee's income is structured, it is possible to certify different levels of income, in some cases vastly reducing the cost to the employer. Advice should be sought when determining contribution levels for various levels of staff, as not only can cost savings be made, but the fines for non-compliance are hefty.

Effect on Employees
If you are an eligible employee, you may have to begin or increase contributions to your employer's pension (unless you decide to opt out). You may also be entitled to receive increased pension contributions from your employer.

As all employees will be automatically enrolled, any individual wishing to opt out will have to directly contact their employer's pension scheme. This is especially pertinent to those individuals with any form of pension 'protection'. Enrolling into a company scheme, even for a month, could invalidate your pension protection and lead to a very unwelcome and significant tax liability. It is vital that you seek advice to ensure your protection is not forfeited and remains relevant and up to date.

With Auto-Enrolment imminent, now would seem a perfect opportunity to discuss these matters, whether you are an employer or employee, or both.

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Selecting suitable funds

When deciding to allocate money to a specific area, we will identify three or four funds which best suit our criteria, using a quantitative screen. This screen enables us to look at all funds in the sector and highlight the most suitable for clients, using many different factors such as performance, volatility, consistency, ratings and size. We will typically not invest in a fund under £50m in size and with less than one year's track record.

Once the funds have been identified, the next stage is the fund manager meeting. This is a crucial part of the process and we will meet the investment house on all funds before they can be included in our model portfolios. Our Chief Investment Officer, Michael Ezra, and Investment Analyst, Stuart Saberi, will attend all manager meetings where they will typically spend one to two hours discussing the fund in great detail.

Areas which will be covered include the fund's performance target, the investment team who manage the fund, the manager's investment style and philosophy, the investable universe, company research and portfolio construction. Within each of these areas, there are many nuances and each fund will seek to achieve it's objectives in a different manner. It is therefore the job of our Investment Committee to identify their favoured fund, out of those met, which best suit our purpose.

These face to face meetings are invaluable and an area where, we believe, we genuinely add value for our clients. It is not uncommon for a fund to have looked an excellent proposition on paper but after a thorough meeting, it transpires that there is a potential issue which will preclude us from investing.

One example where we chose not to invest was into a fund with an excellent track record but which was valued internally rather than having the fund valued externally, which is normally the case. Due to our concern that this could lead to an inappropriate valuation through a lack of independence, we chose not to invest.

Another fund not selected was one which charged a performance fee where performance was in excess of a particular benchmark even when a negative return was achieved. This can result in a large performance fee being charged to investors even when the fund loses money which we viewed as unacceptable.

On occasion, funds have not been selected due to there being too much dependence on a particular individual within the management team or our view that the investment process is not as robust as we would deem appropriate.

In summary, we believe that we have a strong fund management selection process in place to identify suitable funds for our investment panel and to ensure that our clients' interests are considered at all times.

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Stay informed to stay ahead

The 'Silver Pound' used to be a cherished commodity, however with recent changes announced by the Chancellor in his December 'Autumn Statement' this may become more difficult to accumulate. This is due to further reductions to pension benefits through both the Lifetime Allowance from £1.5m to £1.25m and Annual Allowance from £50,000 to £40,000 per annum, a combination that is likely to impact a great many savers.

The changes are effective from the 2014/15 tax year, but the reduced Annual Allowance could start to impact some individuals from as early as 7 April 2013, if the Pension Input Period (PIP) of the individual's pension arrangement is not aligned to the fiscal year.

It is predicted that yet another form of 'Fixed Protection' will be introduced to protect those with pension provision that is anticipated to exceed the new £1.25m limit – allowing the existing £1.5m cap to be retained.

The Annual Allowance

Fortunately, carry forward of unused allowances is set to continue and this is a helpful mechanism allowing individuals to make significant contributions in a particular fiscal year, in order to maximise tax efficiency. At the extreme, currently the maximum contribution can be as high as £250,000, but under the new rules this will eventually drop to a maximum of £200,000.

And those in final salary schemes do not escape, indeed inflation adjusted pension accrual over £2,500 pa could trigger an Annual Allowance charge and the longer the years of service, the easier exceeding the limit becomes – HR departments are going to be busier still.

The Lifetime Allowance

In just two years the lifetime allowance will have fallen from £1.8m to £1.25m, a drop of 30%. This makes careful planning essential and accrued benefits should be assessed to determine whether an application should be made to HM Revenue & Customs for "Fixed Protection 2014". If so, no further contributions can be made after 5 April 2014, therefore planning contributions in advance will be prudent. Indeed when the allowance is reduced, the maximum tax free lump sum limit may also be cut in some circumstances, potentially losing up to £62,500 in tax free cash.

Child Benefit

Finally, by making appropriate pension contributions, it may be possible to preserve some or all of any Child Benefit to which a family may be entitled, as pension contributions reduce deemed taxable income (as do Gift Aided charitable donations).

In short, obtaining timely advice in the whole area of pension and retirement planning remains as critical as ever.

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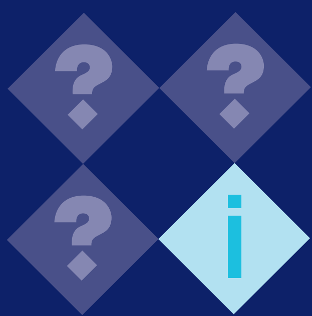

Use them or lose them

As we approach the end of another tax year with the highest rate of tax falling from 50% to 45% from 6 April 2013, it is especially important that individuals consider how to take advantage of the available reliefs and allowances that remain.

Pension contributions – individuals can make contributions of up £50,000 into pensions and obtain tax relief at their highest marginal rate, i.e. up to 50%. They can also catch up on "unused allowances" from previous tax years so that a maximum contribution of up to £200,000 can be made (£250,000 in certain circumstances) where individuals have not had contributions made for their benefit in each of the last 3 tax years, as well as the current tax year. This is a "use it or lose it" opportunity.

Charity donations – tax relief on additional rate taxpayers falls from 50% to 45% from the next tax year, so you should consider making charitable contributions sooner rather than later as 50% tax relief remains available on gift aid contributions made in the current tax year.

ISAs – individuals can contribute up to £11,280 (£22,560 for a couple) in this tax year and enjoy growth, largely free of income and capital gains tax. Similar vehicles are available for children up to age 18 within a Junior ISA where the annual limit is £3,600.

Venture Capital Trusts (VCTs) – we offer advice on such schemes where income tax relief is 30% for investments up to £200,000 and dividends payable from such schemes are exempt from income tax.

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Planning for the unexpected

Being diagnosed with a critical illness is devastating for the individual concerned, family members and friends. As well as the emotional impact, it is also important to consider the financial impact of not being able to work due to suffering a critical illness and to plan accordingly.

Few of us will be fortunate enough to rely on our existing capital to meet ongoing expenditure for an indefinite period of time. In addition, with state benefits being so limited, many will struggle to meet everyday living costs, pay off liabilities such as a mortgage and fund ongoing treatment.

A recent Scottish Widows survey noted that almost one in three households (28%) say they would not be able to cope financially at all if they lost their main income, even where there are two or more incomes. Another 31% feel they would only survive financially for a short period of up to six months, a stark reminder of the dangers of not planning for household security beyond the immediate future.

Fortunately, many illnesses are now treatable, for example a minor heart attack and certain types of cancer and will enable us to return to work within a short space of time. However, it is advisable to plan ahead and consider your options such as a suitable protection policy at the earliest opportunity.

A Critical Illness Plan is a long term insurance policy which pays out a tax free lump sum if you are diagnosed with any one of the serious illnesses covered by the policy. Examples of critical illnesses are:

- **Heart attack**
- **Stroke**
- **Certain types and stages of cancer**
- **Conditions such a Multiple Sclerosis**
- **Kidney failure**

We can provide you with further information on Critical Illness Plans, potential costs and whether they are suitable for your requirements. As Independent Financial Advisers we carefully select suitable products for you from the whole of the market at competitive rates. Generally, we favour plans issued by large well established UK Insurers that provide comprehensive coverage with guaranteed premiums to ensure there are no surprises when a claim is made.

Our consultants can also discuss other protection plans, such as Income Protection which is designed to pay out a regular income in the event of you being unable to work through accident or illness.

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continued from page 3

Enterprise Investment Schemes (EISs) – we offer advice on such schemes where income tax relief is 30% on investments. The schemes also enable capital gains tax to be deferred or reclaimed and potentially provide relief from inheritance tax after two years under Business Property Relief rules. Loss relief is available for all net losses incurred.

Investors should be aware that both VCTs and EISs are high risk investments and specific advice must be taken on appropriate schemes as they apply to individual investors. These investments are not suitable for everyone.

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