ETHICAL INVESTORS

ETHICAL FINANCIAL MANAGEMENT

A Guide to Private Pension Options, State Pension Benefits and Ethical Retirement Planning

2015

Introduction

On 6 April 2001, the then government introduced a new type of pension plan for all those with no access to an employer's pension scheme. The plan is known as a **stakeholder** pension.

This plan has fundamentally changed the way in which individuals plan for their retirement. At the heart of the plan is a charging structure set by government. Instead of insurance and investment companies charging what they want for their personal pensions, if a company is to offer a stakeholder plan, they must conform to the charges and flexibility rules contained within the legislation.

At Ethical Investors, we wholeheartedly support the stakeholder pension plan, and are keen to advise individuals as well as groups of employees to establish their own ethical stakeholder plan. Although the government feels that pensions are so simple that no advice is needed (see later), the reality is that without advice, one cannot be sure that one's most valuable long-term asset is invested to meet one's social and environmental concerns, as well as maximise the financial returns.

In 2012, a new type of quasi-private pension comes in, known as the National Employment Savings Trust. This is a government-backed centralised pension arrangement when individuals have their own account. More on this later.

Finally, for larger amounts of money there is the option of the Self Invested Personal Pension (SIPP) or Platform Pension. We have a separate paper on this type of private pension, but a short outline is given later in the paper.

What is a Stakeholder Pension?

A stakeholder pension is not a State Pension - it's a private pension into which you pay your own contributions. Stakeholder pensions are available to people in employment, fixed contract workers, the self-employed and people who may not be working but can afford to contribute. For example, those who care for relatives, are starting a family, or simply taking a break from work can also contribute to a stakeholder pension, without having to have any earnings. Whether you pay tax or not, tax relief is still given to everyone paying into a stakeholder, subject to certain limits discussed below.

As with most other pension plans, you can pay in contributions regularly to build up your own pension fund and/or can make lump sum contributions. When you retire, or decide to draw benefits, your stakeholder fund is used to buy a pension, usually in the form of an annuity (although increasingly flexible options are becoming available). You do not have to buy the annuity from the same provider with whom you hold your stakeholder pension fund. Your pension income in retirement will depend on the size of your fund and the annuity rates available at the time you take your pension. You cannot withdraw any part of your fund before you retire, but you can move the fund to another provider and convert part of it to a tax-free lump sum when you take your pension.

The manager of your stakeholder pension fund can invest your contributions and the tax relief in assets such as shares, bonds, cash, gilts and property. This is why it's important to start investing early if you can - the longer your contributions are invested the greater opportunity they have to grow.

Stakeholder Standards

Pensions and investment companies will provide stakeholder pensions and they must make sure that these pensions meet strict standards laid down by the government. The standards include:

Charges: there is a limit on the management costs which stakeholder pension providers can charge - this is **1.5%** of the value of your fund each year. The fund manager takes these charges from your fund. There can be no other setting up or exit costs, nor any other charges associated with you increasing, decreasing or stopping your payments or switching funds at any time.

Flexibility: Stakeholder pension plans are flexible and you can make contributions regularly or occasionally. It is usually best to discipline oneself to make regular monthly contributions but you can change the amount you pay in if you need to. All stakeholder pension plans will accept contributions of as little as £20 gross (£16 net). You can stop paying in for a while if you need to, without having to pay any penalty. If you are employed and your employer provides a stakeholder pension they will, if you wish, deduct your contributions direct from your pay.

Information: Your stakeholder pension plan provider must give you regular information about the plan you have joined. This information will include an annual statement to let you know how much you have paid in and details of how your fund is doing. It may also include a forecast of your pension on retirement.

What is a Personal Pension?

Put very simply, a Personal Pension is a private pension arrangement which is not covered by the restrictions, and charge limits, imposed on Stakeholder Pensions. Private Pensions tend to offer a much wider investment choice and, as a result, can sometimes be more expensive than a Stakeholder. With increasing competition, however, it is now not always the case that a Personal Pension has to be more expensive. Where we feel an individual client will benefit from increased investment choice and, importantly, we can arrange a Personal Pension on terms equal to or better than the normal Stakeholder Pension charges, we will recommend this option to a client. Our default position is that we assume a Stakeholder Pension is the best option unless an individual client's circumstances and needs dictate otherwise.

What is a SIPP?

Stakeholder and Personal Pensions are contacts which are offered by a pension provider with, in most circumstances, the investment options being dictated, and often offered by, the product provider. A SIPP, on the other hand, separates the product from the investment choice; one picks the best provider to offer the pension wrapper and then, within reason, one is free to invest in almost anything, from ethical unit trusts, property, direct shares, overseas funds and more. SIPPs are suitable for larger pension pots and this additional flexibility does come at a price; these contracts are not 'expensive', but the ongoing costs are higher than the low cost Stakeholder Pension.

Private Pension Contributions

Income tax relief - The Inland Revenue will add tax rebates to the contributions you make to your stakeholder pension plan. Under present tax arrangements, for each £1 you pay in to your stakeholder pension fund, the Government will add 25p to your fund.

Example: *If you pay in £100 a month, the income tax rebate would increase the total contribution to your stakeholder pension fund to £125.00. If you want to add £100 in total, you only need pay in £80, as the government will add £20 to the plan (as basic rate tax is 20%)*

If you pay income tax at the higher rate (40%) you will be able to claim back extra tax rebates from the Inland Revenue at the end of the tax year, via your tax return.

The tax advantages of pensions are therefore extremely favourable. You receive tax relief on the contribution you make, the investment fund grows virtually free of tax and when you come to retirement you can choose to receive 25% of the fund as a tax free cash lump sum.

With effect from 6 April 2006, the old limits/caps on the amount you can save were removed. The new limits are very simple, albeit quite theoretical for most individuals: the maximum that any individual can pay into their pension arrangements, and still receive tax relief, is now 100% of gross earned income subject to a maximum payment of £40,000. In reality of course, the amount that you save in your pension will be capped by what you can afford to save, but at least you are now free to choose what you want to pay towards your retirement. Your total retirement savings are also not allowed to go over £1,250,000 (for 15/16) which clearly will not affect too many people.

For those with no income at all, it is still possible to invest up to £3600 per annum into a private pension and still obtain tax relief. Payments are made net of basic rate tax. The money can come from any source, which means that an earning partner can make pension contributions into a plan in their partner's name, or parents/grandparents can open a pension plan for children.

The State Pensions

Won't the State Pension be enough for me to retire on?

The government reviews the level of the basic State Pension every year and usually increases it in line with the increase in retail prices. From 2012 it will be increased in-line with average earnings. The full basic State Pension £115.95 a week (for 20105/16). It is highly unlikely that this will be enough to maintain a decent lifestyle for the majority of people, compared to their position whilst they were working.

Everyone retiring after 6 April 2015 will only need 35 qualifying years for the full basic State Pension. National insurance contributions must be made over a period in excess of 10 years (over the working life of the individual) or no state pension benefits of any sort will be paid.

The Pensions Credit

Additional benefits are available that increase the weekly income for those receiving the basic State Pension - for a detailed explanation of this benefit please refer to our separate supplement.

Finding Information on your State Pensions

You can get a forecast of your Basic State pension, State Earnings Related Pension (SERPS) and the Second State Pension (S2P) from The Pensions Service by filling out a form called **BR19,** or online at www.thepensionservice.gov.uk. Changes to state pension ages are explained on the www.direct.gov.uk website. Changes to the retirement age for women are explained on form EQP1a, which can be requested from HMRC on 0845 731 3233

The Additional State Pension

The additional State Pension, or State Second Pension (S2P), related to earnings from employment and, as the name suggests, provides additional income from the government in retirement. It was previously called the State Earnings Related Pension Scheme (SERPS) which started in April 1978 for those in employment. The self-employed were not eligible for SERPS or S2P as they do not pay the relevant National Insurance Contributions.

It is also proposed that in the future the entitlement to the State Second Pension will become a simple, flat-rate weekly top-up to the basic State Pension.

Any SERPS entitlement you have is protected, so if you built up an entitlement to additional State Pension before April 2002 you will keep it, whether or not you've already reached State Pension age. The same applies to S2P benefits accrued from 2002 until the arrangement ceased in April 2012.

National Employment Savings Trust (NEST)

NEST is a straightforward workplace pension scheme for employers to use for their UK-based workers. It means that employers can provide a workplace pension scheme for all of their workers, including those who may not have had access to a pension arrangement before. Employers can use NEST on its own or alongside an existing scheme they have in place.

NEST gives members one retirement pot for life, which they can keep contributing to. If they change jobs and their new employer uses NEST, they can still receive contributions from their new employer into their existing retirement pot. NEST members can choose from a limited range of investment options, one of which is an 'ethical' option. At the time of writing, we have not be able to obtain any meaningful information on what NEST considers 'ethical', how the criteria will be applied and what the mechanism is for members driving changes to the ethical criteria.

Private Pensions FAQs

Should I take out a private pension?

You need to make your own judgement on whether the retirement benefits provided by the state would be enough for you to live on (and enjoy life) when you retire.

Whilst the state does provide a pension for all, and a number of other means-tested benefits on retirement, it is not likely that these will be enough to provide a similar standard of living to that you are currently enjoying.

Although contributing to a pension scheme is an important consideration for the long-term, contributions should not be made if they will prevent you meeting other financial commitments - including mortgage or rent, hire purchase, credit card debts (and possibly life assurance depending on your circumstances).

You should be aware that there are other ways of saving for the longer-term, which do not necessarily need to be within a pension plan. For example, the ISA (Individual savings Account) offers flexibility and tax efficiency outside of the pension rules. We can advise on alternative savings plans, upon request.

If you are employed:

- Does your employer provide a pension plan?
- If yes, check if you are a member of this plan. If not you should be able to join after a brief period of employment.
- Employers' pension plans are always worth checking first as they often have extra benefits, such as added contributions from your employer, free life assurance or nil charges.

It is a legal requirement, in most instances, for an employer to provide access to a pension plan of some sort, (but they do not have to contribute to it on your behalf or offer an ethical option). Note, that there are certain rules, for example there must be more than 5 employees. If your employer does not offer a pension scheme, you can ask if they intend to start one - and if they intend to contribute to it. You may also wish to ascertain if they intend to have an ethical option. If they are prepared to contribute then it may be better to join the scheme rather than selecting one of our stakeholder plans.

If you are self-employed:

- Look into your existing pension arrangements, if any, for example getting a valuation and an illustration of the pension you may receive.

- Check how much you are you currently paying into the plan. It may be appropriate to set up a new stakeholder pension in addition and benefit from tax rebates on the contributions you pay in. Irrespective of the rate of tax you pay, you can make your payments net of basic rate tax (20%).

Existing pension arrangements (and finding lost plans)

- Do you have any other existing pension plan benefits, from personal plans or previous employers? Check the pension plans you have contributed to in the past but no longer pay into today.
- It is well worth tracing pensions that may exist from previous employers. If you have lost track of previous pension arrangements, the Pension Tracing Service may be able to help. All you need is the name of your previous employer or the pension company. Contact 0845 600 2537 or see www.gov.uk/find-lost-pension
- Ask for an illustration/projection of the retirement income you might get from an old pension plan.
- If you are not in an ethical plan, check if your provider has launched an ethical fund since taking out the plan. It may be possible to switch funds internally free of charge. If no ethical option is offered under your existing arrangement, we can arrange to transfer your pensions to an ethical stakeholder plan, usually at NO cost. However, we must first check that your existing provider does not apply a penalty on transfer.
- You may have a number of existing plans, from a variety of sources - Ethical Investors can also advise on consolidating such plans, upon request.

Can I pay into someone else's pension?

The new tax regime allows individuals to contribute up to £3,600 a year to a personal or stakeholder pension regardless of their earnings, including into someone else’s plan. This creates opportunities for relatives, such as parents, grandparents, godparents or aunts and uncles, to contribute to younger family member’s pension arrangements. Alternatively, a working spouse could contribute for a non-working spouse.

Minors - There are a number of rules regarding how a pension contract for someone under 18 is set up, and the payments made, as contracts with a minor are not legally enforceable. Hence, the Inland Revenue requires that the pension contract is taken out by their legal guardian, and that they are responsible for the contract.

Once the contract is set-up with the legal guardian, usually the parents, then other family members can make contributions to the plan. The tax relief is that which applies to the member, not the contributor (for example higher rate tax relief would only be obtainable by the minor if the minor was paying higher rate tax, an unlikely situation).

You should be aware that there may be inheritance tax implications where a person, such as a grandparent, makes a contribution to another person’s pension. There are exemptions under the normal inheritance tax rules, for example there is an annual gift exemption of £3,000.

If you would like to pay into a pension plan on someone else’s behalf, we will be delighted to guide you through the options and implications, including inheritance tax and details of setting up the contract.

Do I need advice?

The Government and the Financial Conduct Authority (FCA) feel that the low charges leave little room for paying for advice. The FCA offers ***Decision Trees***, which are essentially flow charts that will act as a guide to retirement planning under the stakeholder regime. These flow charts are available from the FCA's website (http://fca.org.uk/consumers/financial-services-products/pensions)

Once the desired retirement age is reached an annuity may be purchased, but does not have to be bought from the company providing the pension investment funds – this is called the Open Market Option and to get the best available annuity rate an independent adviser could help.

So, you can go it alone, do your research on fund performance and company stability, as well as research the ethical criteria to come up with your chosen plan. Alternatively, for the same ongoing charge, or less, you can receive advice from Ethical Investors. The choice is yours.

Is it compulsory to make pension contributions?

From October 2012, technically, for employees it will be. The Government introduced *auto enrolment*, which means that employers will be required to place eligible employees into their own pension arrangement, or to make a payment to the employee's NEST account. It will take a few years before all of the rules are fully implemented, but once they are the contributing rates will be as follows:

Employees	5% of pay (after tax relief this will be a 4% cost to the employee)
Employers	3% of pay

Why 8%? – when the Government looked at the area of making it compulsory for individuals to plan for their retirement, their number crunchers calculated that a 30 year old, starting a pension for the first time and paying 8% of their pay for their whole working life could expect an income at retirement of approximately 50% of their final working salary. Now, this is based on quite a few assumptions about growth rates etc, but it is probably the first realistic guide about how much we should all be putting away.

For the self employed, the 8% figure works just as well. As a percentage of earnings, the same assumptions will produce a similar result at retirement.

Investment Performance & Ethical Criteria

Ethical Investors has access to the best of the ethical private pension plans currently available. Indeed, some of the plans we are able to offer to our clients are not available direct from companies and some are not available through other advisers. As one of the leading ethical pension advisers in the UK, our clients benefit from the broadest range of funds and the best financial advice.

As part of our ongoing service to all of our pension clients, we monitor the following areas for each client:

Performance - we meet with the investment managers on a regular basis, to discuss their performance compared to the overall market, as well as other ethical fund managers. If it were felt to be in the best interests of our clients, we would recommend that their funds be switched to another manager. Therefore, our clients have the peace of mind that comes from knowing that we are constantly monitoring the performance of their pension fund and that it is always in the best place for long-term growth.

For stakeholder pensions and some personal pensions, this would involve a change of provider. For the more flexible personal pensions and all SIPPs, changing a fund is a very simple exercise and does not involve changing your pension product.

Ethical Criteria - we believe our service to clients in this area really is unique amongst UK financial advisers. Instead of relying on the general information provided by pension companies, we are able to undertake a far more critical analysis of the ethics of each of the funds we recommend to our clients.

Ethical Investors has access to five full-time ethical researchers, via our sister company *Ethical Screening* (www.ethicalscreening.com), something that no other adviser in the UK can claim. These researchers can verify the investments made by the pension companies, to ensure that they are adhering to both the letter and the spirit of their published ethical criteria.

Behind the scenes, we are in regular dialogue with the pension and investment fund managers, passing on the views of clients and discussing individual investment selections. Therefore, our clients can be assured that the funds we recommend really do continue meet their ethical needs, not just at the point they start their stakeholder pension, but right through until retirement.

Via our website you will be kept up to date with the wider investment market, pension legislation changes and developments within the ethical investment area. We encourage our clients to enter into dialogue with us over developing ethical issues, in order that this can be fed back to the investment managers. The managers welcome this feedback from investors, as it does help to shape the ongoing development of their ethical funds.

Ethical Investors - the ethical pension and retirement specialists

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Head Office: Third Floor, 60 Formal House, 60 St Georges Place, Cheltenham, GL50 3PN
Tel: 01242 539848 Fax: 01242 539851 info@ethicalinvestors.co.uk
www.ethicalinvestors.co.uk **www.ethical-giving.org**

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