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AJBell Investcentre

News & Views

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Welcome

Andy Bell
Chief Executive

Welcome to the latest edition of News & Views.

We now have a listed share price! However, there is no rest for the wicked and so it is back to the day job for yours truly.

I normally open News & Views with a comment on a topical matter or two. The only problem is I have been on a news blackout whilst recovering from the cruellest of derby defeats and the only other topic, involving the 'B' word, doesn't stand still long enough to make a meaningful comment on.

So, let's just dive into the detail, where personally I am happiest.

If you have any feedback or would like me to consider a topic for a future edition, then please let me know at views@ajbell.co.uk

A quiet Autumn Statement for pensions

The last Budget was an unusual one in many ways. The last time we had an October Budget was just after the end of the Second World War, and we haven't had a Monday Budget since the swinging sixties. Of even more significance, this is the first Budget since Robert Walpole's inaugural Budget in 1733 that didn't contain the word 'pension' in it - unless you include the reference to the Secretary of State for Work and Pensions' job title.

As is the case every year, rumours were rife on changes to pension tax relief. That didn't happen.

The Budget announced an accelerated increase in the personal tax-free allowance to £12,500 from next April, one year earlier than promised. Whilst this is good news for most, it exacerbates the net pay issue. Under auto enrolment anyone with earnings above £10,000 will be put into a pension, unless they opt out. Those earning below the personal allowance in a net pay scheme will be losing out versus those in relief at source schemes. This is an issue estimated to be affecting 1 million workers now, with the number increasing as more people will be drawn in from April.

The Budget documents confirmed the level of the lifetime allowance for 2019/20 to be £1,055,000. This was slightly higher than expected as the published CPI for September was 2.4% which, applied to this year's allowance of £1,030,000 and rounded up to nearest £100 (as per legislation), is £1,054,800. Not a big difference but it all helps, albeit not as much as would abolishing the lifetime allowance for DC schemes and getting rid of the complexities of all the various protections.

As expected, ISA allowances remain unchanged and maximum JISA subscriptions for 2019/20 are up to £4,368.

Alongside the Budget documents the consultation response to ban pensions cold calling was published, including draft regulations due to go before parliament anytime soon.

Finally, we had some welcome news that the Government is taking steps to support the launch of Pensions Dashboards (note the plural) and the intention for State Pensions to be included. The fact that funds have been set aside for the DWP to work with the pension industry and technology firms brings the dashboard concept a step closer to reality, although the 2019 implementation deadline still feels on the ambitious side. The confirmation that State Pensions are to be included is a positive as, for many, this will still be their biggest provision in their retirement and without it the value of having a dashboard would be seriously restricted.

HMRC v Staveley judgement and the need for IHT reform

We take a technical turn next, with a look at the recent Staveley Court of Appeal regarding Pensions and IHT.

The facts

Mrs Staveley [Mrs S] was previously a director of Morayford Ltd with her husband.

- She was granted a section 32 pension plan as part of a divorce settlement.
- Mrs S later completed a transfer to a personal pension, knowing that she was suffering from terminal cancer.
- She died six weeks later on 18 December 2006.

HMRC's claim for IHT centred on two issues:

1. Mrs S's estate was reduced at the time of the transfer under section 3(1) of IHTA 1984 ['the Act'] and the exemption from IHT available in section 10 of the Act was not available as the transfer was "intended to confer gratuitous benefit".

Mrs S's estate argued that her only intention was to ensure no part of her fund could be returned to her former company and ex-husband (as may have happened with any excess above the pre A-Day maximum limits) and that the executors should be able to claim the section 10 exemption from IHT on the transfer. However, all three judges allowed HMRC's appeal and claim for IHT on this issue.

One found that, although the nomination under the personal pension was not binding, the circumstances and timing (so soon before Mrs S's death when she was in such poor health) meant the administrators would almost certainly have paid to beneficiaries she nominated.

Death benefits paid from a section 32 plan are not paid on a discretionary basis and without further planning are subject to IHT. Even though Mrs S was unaware of the IHT advantage of the transfer, the nomination under the new plan was executed with the intention of giving her sons a gratuitous benefit. The gift intended by the new nomination was different from the gift made under her will that would have applied to the section 32 plan.

The other judges didn't agree with the first, but also allowed HMRC's appeal because the series of events, mechanisms, and intent were "associated operations" that proved intention to confer gratuitous benefit.

Although her main intention was to prevent any prospect of her ex-husband benefiting directly or indirectly on her death - the transfer and failure to draw benefits were also motivated by a desire for her sons to have the death benefits that would be payable if she did not draw a pension in her lifetime.

Mrs S originally provided that her sons would receive benefits via her will (as the death benefit would be payable to her estate from the section 32). When she transferred to the personal pension she put in place a different mechanism by stating that she wished the death benefits to be paid to them in the nomination as part of the application form, the overall effect and intention was therefore to confer a gratuitous benefit.

2. Mrs S's deliberate omission to exercise a right to benefits after the transfer should be treated as a further transfer of value under section 3(3) of the Act.

The executors conceded that Mrs S's decision not to take benefits was deliberate. Therefore the key consideration for section 3(3) to apply was whether this (continuing) and deliberate omission led to a corresponding increase in the value of her sons' estates.

All three judges found that it did and therefore a claim for IHT can be made under section 3(3).

Issue 2 no longer applies for deaths from 6 April 2011 as legislation was introduced to exempt registered pension schemes (and clients choosing to not draw income from them) from the section 3(3) rules.

What can we learn from the case?

1. Transfers within two years are reportable

We are reminded that pensions are not out of scope for IHT; in fact all transfers within two years of death must be reported on IHT409 forms.

HMRC may claim for IHT where the death benefits are deemed to have a higher value than the lifetime benefits payable after the transfer. A terminal illness increases the value of the death benefits significantly – this is because they are not going to be depleted by lifetime benefits paid to the member who has a limited life expectancy.

Although the case concerned a transfer from a section 32 plan, the wording of the judgment reminds us that transfers between all pension schemes can be assessed and may be deemed a transfer of value for IHT purposes unless the executors can prove life expectancy was not significantly impaired at the point of transfer.

2. Best intentions

Mrs Staveley was apparently not aware of the IHT advantages of transferring a section 32 to a personal pension and the Court agreed that her main intention was to ensure that no part of her pension could make its way back to her ex-husband.

Despite this, the judges found that the executors failed to prove she did not intend to confer any gratuitous benefit by effecting the transfer. They were therefore not able to prove their claim to the section 10 exemption from IHT on the transfer.

The transfer was completed to ensure her sons did receive the death benefits (that also happened to be higher to them due to the IHT difference) and completing the transfer and the nomination form as part of the application confirmed this intention.

For clarity, writing the section 32 death benefit under trust whilst terminally ill would also have been a disposition that triggered an assessment to IHT.

3. The need for IHT simplification

Although the appeal was allowed on both issues, the judges did not agree upon how the intention to confer a gratuitous benefits was conferred and 'Parliament's intention' of the legislation in issue 1.

Freedom and choice over how people can draw pension benefits also introduced a very flexible death benefits regime, meaning pension funds can be passed down through generations. We also have a regulatory cap on the exit charges people face for transferring their pensions to access freedoms in their lifetime.

This suggests the legislation in respect of pensions and IHT is capable of being changed, but it hasn't fully evolved in the same way as other areas of pensions and tax.

With disagreement between the law makers and the first Office for Tax Simplification report on IHT highlighting how complex the interaction with pensions is - it feels the time is right for pensions to be removed from the IHT regime completely.

FCA Platform Market Study

The FCA published its long-awaited interim platforms market study over the summer, with value for money unsurprisingly the main area of focus.

The platform industry has a plethora of different charging structures, with various consultancies coming up with scenarios and heat maps to see which is best for different customers.

To the credit of the FCA, it has cut through this noise and focused on each platform's revenue margin. That is the amount of revenue each platform makes in a year from each £ of assets under administration (AUA).

In 2016, this ranged from the cheapest at 22bps (note we are now tracking at 20.5bps) to the dearest at 54bps. That means the dearest is almost two and a half times the price of the cheapest.

We have asked the regulator to consider requiring platforms to publish this figure – along with the charges a customer will pay on an annual basis – in pounds and pence.

There were a few other relevant issues covered in the report which I'll touch on briefly.

Switching

Switching was the area where I was most hopeful for regulatory intervention, with teeth. Without stating the obvious, any switch between platforms requires the cooperation of both platforms.

Most of the successful platforms are net receivers of switches and therefore have every incentive to speed up the process. But it takes two to tango.

The FCA's approach of watching from the dugout on this one is sensible, leaving it to the industry to develop its own timescales and standards.

One area where more clarity is needed is switches between advised platforms. Advisers are concerned the advice to switch involves a significant amount of work that the client is often not willing to pay for, even though it would almost certainly lead to a reduction in charges and no change to the underlying wrappers or investments.

The FCA has challenged the view that the extra work for the adviser is onerous and questioned what additional work is required over and above the annual suitability test that advisers should be carrying out in any event. There is clearly a difference in expectations and we welcome the FCA's suggestion that further guidance in this area will follow.

Exit fees

The regulator has proposed banning platform exit fees, an approach we have pushed back on. The reality is the platforms on both sides of any switch have to carry out work. If platforms can't charge for this work then the costs will have to be subsidised by other customers.

Exit charges that unfairly penalise a customer or look to recoup acquisition expenses should be banned. Platforms should, however, be able to cover the reasonable costs of switching and one can only hope that as the switching process becomes more automated, the need for these charges will in any event fall away.

Measures to protect orphan clients

Another area of concern for the FCA was the treatment of so-called orphan clients (customers on an advised platform who no longer have an adviser).

I cannot speak for all advised platforms but I think most would agree orphan customers pose a regulatory risk and are operationally expensive to deal with. I suspect most platforms would gladly see orphan customers preferably appoint a new adviser or move to a DIY investment platform.

Any additional charges imposed on such customers are there partly to cover the additional administration costs

and partly as a disincentive to remain as a customer of what is in essence an unsuitable platform.

Model portfolios

The FCA is also worried about the use of model portfolios, in particular ensuring the inherent risk levels are properly articulated and understood.

Model portfolios are very popular with advisers and customers and are crucial to addressing the advice gap. It is the only cost-effective means of advisers being able to advise at the smaller end of the value range.

We'll get an update from the FCA on all these areas in the first quarter of 2019, when the final report is due to be published.

What I'd like to see following Berkeley Burke v FOS

This month saw the publication of another judgment, this time from the High Court involving the Financial Ombudsman (FOS) and Berkeley Burke.

The judgment relates to a complaint about an investment, made in 2011, which involved direct investment in overseas properties in Cambodia and which turned out to be fraudulent. The business was introduced to the SIPP operator through a commercial relationship it had with an unregulated introducer. FOS first reached a decision on the customer complaint in 2014 but it was agreed that they would reconsider. In 2016, FOS upheld the customer's complaint finding that the SIPP operator had not exercised due skill, care or due diligence when assessing whether or not the investment was acceptable for his pension scheme and thereby had failed to treat the customer fairly. The SIPP operator applied for judicial review of the FOS decision on the grounds that in making its decision FOS had erred in law but the High Court dismissed the application, concluding that there had been no error of law by FOS.

The extent to which the impact of the judgment will be restricted to investments involving fraud and overseas property, or whether it might extend to investments which have failed for broader economic reasons rather than fraud is not yet clear. However, based on our assessment of the judgment, I have no reason to believe there will be any material impact on our financial position either immediately or in the future and we have already responded to the FCA's Dear CEO letter on this basis.

Although the number of cases of consumer detriment is relatively small in scale in the context of the overall market, their impact is disproportionately large. In addition to the impact on the individual investors, the negative publicity they inevitably generate causes huge harm to the reputation of SIPPs in general, the majority of which are performing an important role in helping people save for their retirement. By extension, this risks causing damage to people's confidence in pension savings more generally.

The Financial Services Compensation Scheme (FSCS) is often forced to step in to compensate investors, pushing up levies for advisers and the industry and, ultimately, increasing costs for savers. These failures cause huge financial and emotional distress for the investors affected and as the SIPP market continues to grow, this problem has the potential to get worse. The FCA has already taken a number of steps to address the issues, including the restrictions it has placed on the promotion of non-mainstream collective investments, the updated guidance provided to SIPP operators, its ScamSmart campaign and the introduction of the 'new' SIPP capital framework in 2016.

The FCA's SIPP capital framework has almost certainly reduced the flow of assets into unsuitable investments with the introduction of its standard investments list and increased regulatory capital requirements for those SIPP operators with a greater historic focus on non-standard investments.

The new capital regime has been in place for two years now and I think that provides a natural point to review the impact it has had and consider further consumer protection measures.

In particular, I think now is the right time to consider a more prescriptive due diligence process that SIPP providers need to follow when deciding which investments to allow within their products.

The current process that, from an FCA regulatory perspective, falls under the Principles of Business and Treating Customers Fairly rules leaves too much scope for providers to define their own due diligence responsibilities. It will always be difficult for the regulator to supervise all firms intensively, so I'd like to see the FCA work with established SIPP providers, to define a more prescriptive due diligence process for investments that are allowed within SIPPs.

This should include:

- A review of what constitutes a non-standard asset and reclassifying those where there is little likelihood of consumer detriment – for example fixed term cash accounts which may not be realisable within 30 days but, in most cases, are readily transferable and would be accepted by almost all SIPP operators.
- Clear and explicit rules around due diligence requirements, including exactly what SIPP providers need to check and what they don't for different types of investments.
- More stringent requirements for non-standard investments and business introduced by unregulated firms compared to standard investments and business introduced by regulated financial advisers.
- A requirement for SIPP operators to be able to demonstrate that they have taken all reasonable steps to ensure the customer has understood the risks of investing in non-standard investments before the investment is made.

More importantly, I believe this would lead quickly to even more SIPP operators not allowing access to non-standard investments, and would prevent investors unwittingly finding themselves in investments that fall in the 'too good to be true' category. It would represent a genuine stride forward in consumer protection, creating a safer space for people to save for their futures and lower interim levies for advisers and industry.

Scottish (and Welsh) Income Tax

Whilst the Budget gave details of the personal allowance and tax bands for most of the UK, those living in Scotland have a little longer to wait to see what they'll be paying next year. The Scottish Budget date has been set for 12 December.

Revenue Scotland has the power to set both the rate of tax and the tax bands. Last year they made full use of this power to add an extra two tax bands – the starter rate band between £11,850 and £13,850 and the intermediate rate band between £24,000 and £43,430. By introducing the intermediate rate band they kept their promise of not raising the basic rate of Income Tax – instead they just moved an estimated 875,000 taxpayers from basic rate tax to the intermediate rate at 21%.

This means any Scottish taxpayers earning over £24,000 and making pension contributions to a personal pension or NEST (or paying to charity) will need to contact HMRC at the end of the tax year to get the balance of tax relief they are due because relief at source and gift aid only relieve at the UK basic rate (20%).

Since April 1944 the UK system has broadly worked so that the majority have their tax collected through PAYE and schemes that relieve do so at the rate that applies to most citizens. Unlike a lot of the rest of the world most people don't have to contact the tax authorities yearly to pay the right amount of tax.

These new tax rates for moderate Scottish earners have just pulled them all into a requirement for annual contact with HMRC. It is possibly fairer but much less easy to deal with. It appears that in a bid to be fair, the Scottish Parliament has forgotten about ease and cost of compliance.

But don't worry, it can only get better; payroll is already set up with the functionality to accept 10 Scottish tax rates. One day we may look back fondly to the year when there were only five!

From 6 April 2019 Wales will also have the ability to set its own Income Tax rates. Similar to the Scotland deal, Welsh taxpayers will see each of the three rates of UK Income Tax – basic, higher and additional rate – reduced by 10p. Each year, the Welsh Government will then decide the three Welsh rates of Income Tax, which will be added to the reduced UK rates.

HMRC continues to collect the tax for all of the UK, but will then pass the relevant portion back to each nation.

The good news is that the Welsh deal does not allow for changes to bands – that power remains with the UK Government so we will not see a repeat of the multi-tiered Scottish situation.

The Welsh Government has also decided to set the first Welsh rates of Income Tax at 10p, keeping it the same as rUK for 2019/20, and has committed not to raise Income Tax rates until the end of the current Assembly (May 2021). The shift of power though does mean that from April we will have to identify all pension scheme members as either C(Cymru), S or rUK.

Follow Andy Bell @Snooper66