November 2016

AJ Bell Investcentre

News & Views

In this month's issue

Welcome

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My usual Summer edition of News & Views was replaced by a 'Brexit special', given the importance of those events, so welcome to the first regular edition for a little while. With progress towards Article 50 taking longer than some may have hoped (and, in the interests of balance, happening more quickly than others might have wished!) I suspect I could probably continue writing Brexit specials for some time yet.

Thankfully there are plenty of other issues to consider outside the UK's path towards Brexit, so hopefully you will find this quarter's edition an enjoyable read.

If you have any thoughts regarding any of the articles in News & Views, or would like me to cover any particular topics, I'm always happy to receive feedback and suggestions at marketing@investcentre.co.uk.

Before moving on to this quarter's News & Views, a brief update for the Intelliflo users amongst you. I'm pleased to confirm that the AJ Bell Investcentre platform has been enhanced to provide weekly adviser charge statements that can be automatically reconciled in Intelligent Office.

Adviser charge statements will now automatically be downloaded into Intelligent Office and then matched to payments received each week. These statements will include all adviser charge payments (and refunds) processed in the previous week.

Platform profitability issues continue – new FinalytiQ report

Back in April I wrote about challenges facing platforms and the need for a sound investment infrastructure that has to be well considered and sustained over a period of time, with a clear focus on progressive development. Investment in IT is needed to maintain a robust, secure and scalable platform and this is an ongoing commitment. Platforms that have under-invested in their technology in the past are now spending eye-watering sums of money playing catch up.

Others have decided they don't want to make this investment and have put their platform operations up for sale.

The underlying issues here are intertwined – platform profitability and regulatory capital.

All of this is brought to life in FinalytiQ's latest Advised Platform Report – Who says elephants can't dance? Whilst the title may suggest Ed Balls on Strictly, it is a stark and sometimes worrying analysis of the viability of the platform market. A few noteworthy highlights:

- FinalytiQ estimates that almost £200 billion of assets is planned to be migrated to new technology in future, at an eye-watering cost of circa £820 million.
- Platform AUA grew 17% in 2015 to £360 billion, with revenue up 5% to £1.07 billion.
- However, despite this the industry sank back into the red, reporting an aggregate pre-tax loss of £19 million.
- Of the 26 platforms covered in the report this year, only 15 of them reported any profits at all in 2015.
- Only 11 out of 25 platforms have positive cumulative retained earnings.
- It is perhaps affirmation of the strength of our business model that AJ Bell was the only platform that featured in both the top five platforms ranked by AUA and by pre-tax profit.

Platform	AUA (billion)
Cofunds	£76.9
Fidelity	£60.2
Old Mutual	£34.5
Standard Life	£27.5
AJ Bell	**£26.1**

Platform	PTP (million)
Transact	£20.8
AJ Bell	**£15.5**
7IM	£12.5
James Hay	£9.9
True Potential	£9.3

Much of the content in the FinalytiQ report will be useful for any adviser currently carrying out platform due diligence. A copy will normally cost you over £300 to buy, but we have paid for the rights to distribute it to advisers - so you can download a free copy here.

Why should profitability matter to your clients?

As the FinalytiQ report suggests, it is all about sustainability.

Recent history suggests that platforms with little or no profits may be faced with a sale, merger or an increase in pricing to survive longer term. That uncertainty is rarely good for advisers or their clients.

It has always been a concern of mine that if a platform cannot keep control of its cost base, then it will continue to find that the bottom line suffers. A parent company might have deep pockets to prop things up but there is a point where shareholders will eventually run out of patience.

Another question I would be asking myself as an adviser recommending a particular platform for a client is how sustainable the current pricing structure is? For example, an aggressive pricing strategy aimed at driving new business for a firm that is operating in the red will eventually lead to consequences in the guise of a price increase, change in strategy or possible sale sometime in the future.

Re-platforming

As we have seen, the spiralling costs of re-platforming, i.e. where a platform provider changes technology, continue to prove rich pickings for the financial press. The cost inevitably causes the platform provider (and in some cases its parent company) pain, particularly where we are seeing budgets overspent three- or four-fold.

For clients and their advisers though, the pain is really felt via the disruption to the business and therefore in the ongoing service. Even with the best planning, resources are often stretched to the limit and ongoing investment in further infrastructure and service developments has to be put on hold.

With consolidation playing an increased role in the market, it isn't just re-platforming that is the culprit - the forthcoming mergers of some big players in the platform market will lead to further disruption.

Moving client assets

With all the turmoil and takeovers in the market, you might be considering a move for some clients at their next review.

If you're thinking of moving assets to another platform, here are some pointers that may help.

Speed

The ease with which you can move platforms is improving all the time. Research from Altus reports rapidly growing adoption of electronic standards across major platforms for in specie transfer of funds. What used to take weeks or even months can now take days. Where electronic in specie ISA and GIA transfers are possible the process can be complete within days. The main outliers are unusual or non-readily realisable investments, and platforms that transfer funds in batches rather than all at once. This should continue to improve as standards continue to be upgraded.

Compliance

Cost isn't everything but if you're moving assets to a cheaper platform, it's fairly simple to justify, particularly where the new platform is making profits and has a strong balance sheet. Whilst the move would of course be an advice point for each client, if your current platform is more expensive you'll save the client money with each move, and be able to demonstrate to them that you've got their best interests under constant review.

Lower advice costs

The consequence of this is a reduction in the time taken to advise on and administer a switch to a new platform. For those platforms set for change on the back of a recent acquisition, or a major re-platform, advisers are faced with the headache of retraining staff, managing clients and dealing with changes to charges or functionality anyway. Moving to an alternative platform allows you to manage the message and control the pace of change, rather than being driven by events outside your control. If you are considering change, my advice would be to do it in advance of any planned re-platform by your current provider.

Simple and stable – not a lot to ask for, is it?

As some of you may have read I recently took an opportunity to write an open letter to our new Chancellor, Philip Hammond. I focussed on highlighting the harm caused by the persistent tinkering and growing complexity we've seen in recent years in relation to our two most important long-term savings products – pensions and ISAs.

Every six months we've seen speculation about further potential changes to both. This has led to savers making choices driven by fear of change, choices which may not have been right for them and, in many cases, will not have been good for the economy. In the last year we've seen a huge increase in pension contributions driven by uncertainty over the future of tax relief. We've estimated that this could have cost the Treasury as much as £1.5 billion in pensions tax relief that would not have been paid out if savers had been able to make rational decisions rather than choices based on fear.

The two calls I've made to the new Chancellor can be summarised in two words – simplicity and stability.

My call for simplicity relates to both pensions and ISAs although, in the letter, I've focussed on the latter. I haven't completely given up hope that pensions truly can be simplified but, ten years on from 2006 and so-called 'simplification' and it feels like we're in a worse place than we were before A-Day. When it comes to ISAs my fears that the system is in danger of becoming too complex were borne out by the fact that over 60% of advisers who took part in a recent poll said they felt ISAs were becoming too complicated and hard for customers to understand.

When it comes to ISAs we now have cash, stocks & shares, junior, innovative finance, help-to-buy and soon we'll have a lifetime version. Particularly worrying for me is the way in which the rules for the new lifetime ISA are being written.

Historically all ISA legislation has been built on a single set of ISA regulations. The growing list of ISA types has not been helpful but at least everything has been based on one piece of legislation. The lifetime ISA will see us moving away from this. Much of the legislation for the lifetime ISA will sit separately from all earlier ISA legislation and appears to have been drafted by the pension experts at HMRC rather than the ISA experts.

This strikes me as dangerous. The Government needs to get a grip of the ISA system before it becomes too complex. We, and more importantly investors, only need one ISA with a single set of rules that can cope with the different options currently available to savers through the variously branded ISAs.

Alongside my call for simplicity I've also asked for stability. Philip Hammond is the third Chancellor I've asked to establish an independent Pensions Tax Commission so that the current system can be assessed free of any political bias.

The Commission's review should be focussed on the four principles that sat behind the 'Strengthening the incentive to save' tax relief consultation, namely:

- Simple and transparent
- Allow individuals to take personal responsibility for ensuring they have adequate savings for retirement
- Build on the early success of auto enrolment in encouraging people to save more
- Be sustainable

Once the Commission's assessment has been completed, and any changes which can be made to ensure the pensions framework better meets the four principles implemented, we need a pledge for the key pension tax relief rules to be frozen for a period of time. Only a period of stability of, say, 10 years will allow savers to make decisions over their long-term financial future from a position of certainty.

Scrapping of the secondary annuity market

A recent policy announcement that I have been advocating for some time and wholeheartedly support is the scrapping of the Government's plan to launch a secondary annuity market.

Personally I believe that the original idea was driven by the perceived success of the pension freedom rules, but any examination of the detail demonstrated a lack of understanding on the part of its sponsors.

The one solution that might have worked was the solution excluded from the original proposals. That is to allow insurance companies to buy back their own annuities, i.e. to offer a surrender value on an annuity product, subject to medical underwriting. Maybe high risk from an advice perspective but nevertheless, to my mind, a step forward.

Pensions and bankruptcy - *Horton v Henry*

The vast majority of pension rules come from legislation, so it is interesting to get some case law once in a while.

Horton is a recent Court of Appeal case concerning the extent to which a pension scheme is protected under bankruptcy.

Whilst only relevant to the minority, it is an important advice point when advising on pensions.

Before we get to the details of the judgment and its implications for pension schemes, here is a recap of the position before the case came to court.

The legislative background

From May 2000 onwards, the general position has been that funds held in a pension scheme do not form part of an individual's estate for bankruptcy purposes.

Therefore, whilst a Trustee in Bankruptcy (TIB) may be able to claim other assets belonging to a bankrupt, they could not claim any funds held in a pension scheme.

A TIB could, however, ask the court to grant an income payments order (IPO), under which they can claim a portion of any income to which the bankrupt is 'entitled' (and which is above and beyond their reasonable ongoing needs). Income in this context includes pension income.

The case of *Horton* hinged on the technicality of whether an individual became 'entitled' to pension income purely by turning age 55. If they did become entitled, it would follow that a TIB could effectively force a bankrupt to crystallise their pension and claim income from it.

This question took on added meaning in April 2015 with the introduction of flexi-access drawdown. Depending on the outcome of the Horton case, a TIB could potentially access the whole of a bankrupt's pension fund via an IPO.

Previous case law

This question of entitlement had previously been addressed in the 2012 High Court case of *Raithatha v Williamson*.

In *Raithatha*, it was held that the entitlement to income did arise at age 55 and regardless of whether the individual had taken benefits or not. An IPO could therefore be applied to uncrystallised funds.

This was viewed by many commentators (including me) as being somewhat controversial (that is me being polite) as it did not fit in with the general theme that pensions were protected from creditors. There were also question marks over whether it had a sound basis in law.

In 2014, a very similar case presented itself before the High Court. This was the first instance decision of *Horton v Henry.* However, the judge wisely declined to follow the judgment in *Raithatha*. He held that the 'entitlement' to income only arose once the funds had been crystallised. This meant that it would not be possible to compel a bankrupt to crystallise funds.

Horton v Henry – Court of Appeal

We therefore had two contradictory decisions from the High Court, which meant there was a great deal of uncertainty for TIBs, bankrupts, pension providers and advisers.

The TIB in Horton appealed the decision to the Court of Appeal earlier this year. However, the Court of Appeal dismissed it, upholding the original High Court decision.

The judge made it clear that a TIB could not compel a bankrupt to crystallise their pension fund via an IPO. Furthermore, a TIB could only include income from a pension in an IPO if the pension had already been crystallised at the time of bankruptcy.

As such, we are now back in the position we were in before *Raithatha*.

Hinton v Wotherspoon – IPO in practice

Technically *Hinton* was heard before the Court of Appeal decision in *Horton* but it followed the original High Court decision in the *Horton* case (which ultimately the Court of Appeal agreed with).

It is notable because the judge said that the mere presence of a drawdown fund is unlikely to be sufficient to show the necessary 'entitlement' to income - the bankrupt actually needs to have requested some income from the drawdown fund before an IPO can be granted against it.

Hinton involved capped drawdown, so we do not know how it would work with flexi-access drawdown. In addition, these comments were not part of the main judgment so they are not technically binding.

Insolvency Service guidance

Curiously though, the key factor may not come from legislation or case law, but from the official guidance issued to insolvency practitioners.

As you may recall from my April 2015 News & Views, the guidance was updated in March 2015 such that an individual over the age of 55 may not be eligible to petition for bankruptcy in the first place if they hold uncrystallised funds. This effectively dodged any questions about the legal niceties of IPOs.

Therefore, while we now have welcome certainty from a legal perspective around when an IPO can be used in respect of a pension, there are still some wrinkles about how it might work in practice.

Distributing death benefits

The introduction of the pension freedoms was trumpeted by our then Chancellor as being the most significant change to the rules covering pensions in a century.

That is one point on which I won't argue, although it is worth noting that the change in the rules did not lead to a change in behaviours of anything like the same significance.

The most popular option when savers enter drawdown is still just to take their tax-free cash and not withdraw any taxable income, and the vast majority of those who have been given the option of taking their whole fund as a single payment have chosen not to do so.

One of the lesser publicised aspects of the pension freedoms will have contributed to this behaviour. The change to taxation of death benefits makes it simpler to pass pensions through several generations of a family whilst minimising the tax paid on those funds. For many, the ability to do this has trumped any desire to withdraw large amounts from their pension.

With this opportunity comes the need to take even greater care than pre-pension freedoms when distributing death benefits.

At AJ Bell we have a robust process when exercising our discretion regarding distribution of death benefits. We have a dedicated administration team dealing solely with death benefits who liaise directly with all the parties acting in respect of the deceased member and their estate.

It is the team's job to gather all of the information and documentation we need to ensure that death benefits are being distributed to the most appropriate beneficiaries. The taxation those beneficiaries will have to pay has always been a factor, but is playing a more important role under the new rules.

Previously only a limited number of beneficiaries, often only the former spouse, would have been eligible to receive death benefits as a pension. All non-dependent beneficiaries would only have had the option of receiving death benefits as a lump sum.

Even when this was the case it was rarely, if ever, appropriate to automatically pay death benefits to the spouse without investigating whether other potential beneficiaries also needed to be considered. Now, with a potentially much wider range of beneficiaries eligible to receive death benefits as a pension, it is even more important to take time to establish the appropriate distribution.

As a gentle reminder - our expression of wishes and nomination form has been redesigned in light of the changes. It has been designed to give the most flexibility possible when it comes to paying out death benefits.

The form itself is split into two sections – one for nomination, and one for expression of wishes. The nomination section is the legal bit that nominates all eligible benefit recipients, as set out in our scheme rules. This means that where our form has been completed a very wide class of individuals are eligible to receive the death benefits as an income, in addition to having the lump sum option available to them.

By structuring our form in this way it means individuals who are not specifically named in the expression of wishes section will have the option of receiving death benefits as a pension, not just a lump sum, where it is deemed appropriate for benefits to go to them.

Personal circumstances are becoming more complex and whilst I know many of you already do this, reviewing the situation on death at least once a year with your clients is crucial. This also opens up the opportunity to discuss the option of passing the money to the next generation in the form of a SIPP fund rather than a cash payment, which is an incredibly tax-efficient option.

Techie corner – in specie contribution issues

Given the frequency with which the rules governing pensions are changed it is not surprising how frequently anomalies in the rules or differences in interpretation between HMRC and the industry arise.

It is perhaps more surprising when these sort of issues crop up when the rules are not meant to have changed for approximately 10 years. To the alarm of many working with SIPPs and SSASs this is what appears to have happened in relation to in specie contributions.

The process that needs to be followed in relation to in specie contributions was established through correspondence between HMRC and the SIPP/SSAS industry in the period immediately after A-Day. It was formalised into HMRC's published guidance in 2009 and included a requirement for a contribution to be for a monetary amount.

The guidance also requires the creation of a clear obligation on the saver to pay a contribution of that specific monetary amount, which in turn creates a recoverable debt obligation. Separately, the trustees of the pension and the member must come to an agreement for the debt to be settled by the asset being moved into the scheme as a consideration.

In the seven years since, scheme administrators have followed what they believed to be HMRC's requirements with little if anything indicating that HMRC had any problems with what was going on.

In order to claim relief at source on personal contributions made to pension schemes, scheme administrators are required to submit a return to HMRC. Before April of this year the form didn't include anything that would highlight the payment of an in specie contribution. Since April the form has included a question asking administrators to confirm whether any part of the reclaim relates to in specie contributions. This seems to have been the catalyst for a change in HMRC's stance on these transactions.

HMRC has been investigating these in specie contributions where they have been highlighted and is reported to have withheld tax relief on the vast majority of payments. Several reasons have been given for the decision to withhold tax relief. These have included alleged failures to follow HMRC's published requirements. It has also been reported that HMRC has refused to pay tax relief where it believed the original intent was to move the asset into the scheme rather than for a monetary amount to be paid.

Very few, if any, in specie contributions will have been made with an intent to game the tax relief system. The only circumstance in which this might be the case is where the asset being contributed is an investment that can be valued in inventive ways – so intellectual property as one example.

Given that the vast majority of in specie contributions will be made for entirely genuine reasons, HMRC's starting position should have been to work with providers to resolve the misunderstanding. Instead it appears someone at HMRC has decided this is an opportunity to make a quick buck – or several million bucks if estimates are to be believed – all at the expense of investors and providers who were genuinely trying to do the right thing.

If this situation turns legal it will be interesting to see where fault is found – if HMRC has published guidance which has been interpreted in a particular way by the vast majority of firms, there must be a strong argument that the blame for the problem sits at the door of the organisation which provided the guidance.

Thankfully we don't have any clients affected by this but, until HMRC puts its own house in order and provides guidance that cannot be misinterpreted by an entire industry, we won't be accepting any further in specie contributions. That's a shame when the Government is trying to encourage saving.

Investival

To close it is worth mentioning that the latest edition of News & Views will be hitting your inbox with less than two weeks to go before our next Investival event.

Hopefully I'll have the opportunity to catch up with plenty of readers at some point during what looks set to be another excellent event.

With 400 advisers due to join us on the day I'm reliably informed that Investival is now the biggest adviser investment conference in the UK which, considering the event was only launched four years ago, is a testament to the quality of speakers we have been able to attract.

This year we will be welcoming the likes of Richard Buxton of Old Mutual and Mark Barnett of Invseco Perpetual, and we'll again be running a Q&A session with Neil Woodford.

Our non-investment speaker, former Arsenal and England footballer Ian Wright, carries on our tradition of providing quality evening entertainment. I'm sure Ian will be just as entertaining as David Lloyd, Andrew Flintoff and Gary Neville have been in previous years. Maybe next year I'll be allowed to have an ex-Everton footballer as the evening guest – we'll have to wait and see.

Talking of next year, if you haven't been able to obtain a ticket for this event (we've had to operate a waiting list for the last couple of years), I'd recommend putting your name down as soon as the invites are issued next time.

Knowledge

150% of GAD maximum drawdown rates applicable for capped drawdown calculations in November 2016 per £100,000 of fund (2.00% gilt yield)

Age	Annual income
55	£6,150
60	£6,900
65	£7,950
70	£9,300
75	£11,550

Pension allowances

	2016/17 tax year
Annual allowance*	£40,000
Lifetime allowance	£1,000,000

*Carry forward of up to £50,000 available for 2013/14 and up to £40,000 for 2014/15 and 2015/16

ISA subscription limits

	2016/17 tax year
ISA	£15,240
Junior ISA	£4,080

Inheritance Tax

	2016/17 tax year
Nil-rate threshold up to	£325,000

Inheritance Tax is charged at 40% above the nil-rate threshold. The 40% rate is reduced to 36% where at least 10% of the net estate is left to a charity.

Any unused nil-rate band may be transferred to the deceased's spouse or civil partner.

Capital Gains Tax

	2016/17 tax year
Annual exempt amount	£11,100
Capital Gains Tax rate (if the higher rate threshold has been reached)	28%
Capital Gains Tax rate (if any basic rate band has not been used)	18%

Income Tax rates/thresholds

	2016/17 tax year
Basic rate	20%
Higher rate	40%
Additional rate	45%
Personal allowance	£11,000
Higher rate threshold	£43,000
Age-related allowance (for those born 6/4/1938 - 5/4/1948)	£11,000
Age-related allowance (for those born on or before 5/4/1938)	£11,000
Personal allowance income limit	£100,000
Additional rate threshold	£150,000

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