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Newsletter

Spring 2006

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**W**elcome to the spring newsletter for 2006. As usual there are plenty of items to report on, and we have tried to present a cross section of topical items within this bulletin. If you require any further information on these items please do not hesitate to contact us.

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### **Staff Announcements**

**Alan Harte** has recently joined PCS Ltd as a Compliance Consultant. Alan has considerable experience in the provision of advice in the Equity Release & Pension markets and his appointment will bolster the team in these specialist areas. Alan has passed the AFPC exams (including G60) as well also being ACII qualified.

**Edward Barker** also joined us earlier this year. Edward's background is predominantly IT and software based, especially 1<sup>st</sup> and Sage, however he is now progressing through the ranks as a trainee compliance consultant.

# **Budget 2006**

This section focuses on the proposed major changes to the life and pensions industry, following the 2006 Budget Report. The key points include:

- Major changes to inheritance tax and trusts effective immediately
- Clarification of the inheritance tax treatment of pension death benefits post A-Day
- Further details and changes to tax-free lump sum recycling

## **Inheritance tax and trusts**

Major changes were announced to the way in which interest in possession (IIP) trusts and accumulation and maintenance (A&M) trusts are to be treated for inheritance tax purposes.



From 22 March 2006, interest in possession (IIP) trusts and accumulation and maintenance (A&M) trusts will be subject to the same IHT rules as discretionary trusts, although there will be a few exceptions. This means:

- Payments into the trust will be chargeable transfers, with a possible immediate 20% IHT charge;
- A periodic charge will apply every ten years at a rate of up to 6%; and
- There will be an 'exit charge' proportionate to the periodic charge when funds are removed between ten-year anniversaries.

Full details of the changes can be found on HMRC website:

<http://www.hmrc.gov.uk/budget2006/index.htm>

These major changes mean that you should undertake a review of all inheritance tax planning cases to determine if the original advice is still appropriate.

## **Inheritance tax (IHT) and pensions simplification**

The Chancellor has at last clarified the IHT treatment of pension death benefits from A-Day. The new IHT rules will be included in the Finance Act 2006.

The existing rules where a pension scheme member dies before age 75 will continue and will now be formalised in legislation.

New IHT rules will apply if the pension scheme member dies after the age of 75 and the individual is drawing an 'alternatively secured pension' (ASP), any 'transfer lump sum payment' (i.e. transfer to another scheme member) will be subject to IHT, unless the recipient is a spouse, civil partner or someone financially dependent on the scheme member. Death benefits paid to charity will be IHT free.

In certain circumstances a double tax hit can be suffered if a dependant inherits the fund on a pensioners' death in ASP and then dies before age 75. In this case the fund is not

only subject to IHT but the remaining fund after IHT, is also subject to the usual 35% tax charge if paid as a lump sum.

The scheme administrator will be responsible for accounting for and paying any IHT.

Full details of the changes can be found on HMRC website:

<http://www.hmrc.gov.uk/budget2006/index.htm>

### **Changes to tax-free lump sum recycling**

The Chancellor has confirmed that the anti-avoidance measures will not apply where no more than 30% of a lump sum is recycled or where the lump sums are less than £15,000. This threshold will be increased in line with the standard lifetime allowance.

Full details of the changes can be found on HMRC website:

<http://www.hmrc.gov.uk/budget2006/index.htm>

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## ***SAFEGUARDING YOUR MOST IMPORTANT ASSET - BUSINESS DATA AND RECORDS.***

The aim for most offices nowadays is to become paperless. It is commonplace to see firms scanning documentation or using Document Management Systems instead of numerous heavy, space steeling filing cabinets.

Whatever system you choose to store your business data, be it Volume, 1<sup>st</sup>, Quay, Fin Plan etc, it is not just a case of feeding it through a scanner, or outsourcing it to a scanning company. You have to think about how the data will need to be retrieved and utilised on a day to day basis, in the future and in the event of a regulatory visit. Implementing a simple robust procedure is the key to enable everyone, down to a new recruit to retrieve it easily and logically.

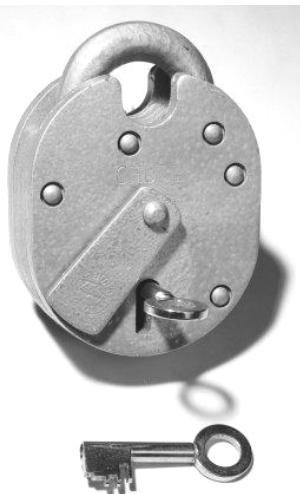
The financial services industry alone produces an immense amount of paper in different mediums including emails, illustrations and research in many different formats. As individuals, we don't all think alike so do not assume that data will be stored uniformly without procedures in

place. Our experience has shown us that this is absolutely not the case. In some instances it is not only time consuming and difficult to retrieve information, there is often no set of logical procedures being followed to store data. The main areas to implement a good step by step procedure we believe are:-

**Preparation** - Take time to plan where data should be stored / allocated on your system.

**Standardising** – Having an agreed set of rules or standards covering the process. In this way all staff know what is expected of them. Keep it simple – if too complex it is harder to follow and train.

**Training and Discipline** – Putting the standards described above into practice and ensuring they work properly. This develops and maintains good work habits.



**Monitoring** – Spot checking / auditing of clients data files to ensure all items are allocated to their correct areas.

#### **SOME TIPS TO GET YOU STARTED**

- Get staff involved – they have the greatest input - if they set up the procedures they are more likely to buy into it.
- Ensure management commitment by providing appropriate resources – i.e. training, time for staff meetings.
- Use set headings for identified areas of data
- Use uniform entry types for each document / data item
- Keep it simple
- If outsourcing to scanning firm, ensure files are sorted prior to scanning otherwise you could be looking for a needle in a haystack!
- Finally, and most importantly, it is vital that the data is backed up and that the backup is checked regularly to verify that it works

*The upside of this for the future is that it will improve efficiency, create proactive client relationships as you will have everything at your fingertips, improved security and increased profitability.*

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## **Winding-up a Occupational Money Purchase Pension Scheme**



Pensions Simplification and some of the effects of the Pensions Act 2004 will come into force on the 6<sup>th</sup> April 2006. This will mean that Employers & Trustees of Occupational Money Purchase Pension Schemes will have a duty to review the implications of the legislation. They will be seeking advice regarding the effects of the legislation and the options available to them.

One of the options available to them is to wind-up the Occupational Pension Scheme and replace it with a Group Personal Pension Plan or a Group Stakeholder. The FSA are concerned that Financial Advisers do not consider and discuss all the available options with their clients and this results in the unnecessary switching of Pension Schemes.

If you are active in this market you should document that all the available options have been considered, including the option of leaving the existing Pension Scheme in place. All options should be discussed and discounted, where appropriate, in the suitability letter to the Trustees and / or the Employer. The suitability letter should also document the potential effect on the member's existing and future benefits, e.g. changes to tax free lump sum etc., should the Pension Scheme be wound-up.

The FSA will be closely monitoring this area of activity and may undertake themed visits in 2006.

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## FSA Lifetime Mortgage Thematic Visits (Spring 2006)

The FSA carried out a mystery shopping exercise and undertook Lifetime Mortgage thematic visits in early 2005. The results of the exercise were issued in May 2005 in Briefing Note BN005, full document available at <http://www.fsa.gov.uk/pages/about/media/notes/bn005.shtml>. The survey highlighted the following shortcomings:

- Insufficient information was collected by the adviser to demonstrate they knew their client.
- Some advisers failed to explain the downsides of Equity Release schemes.
- Some advisers failed to explain what would happen if the client wanted to move home in the future.
- Some advisers failed to mention that the client would have to pay an arrangement fee to apply for a Lifetime mortgage.
- Some advisers failed to provide information to the client about how the loan is repaid.
- Some advisers did not look at the effect of releasing monies on State benefits or if Local Authority grants were available.



In addition the FSA looked closely at the subsequent investment advice given to clients who had released equity from their properties. The investment advice falls into three key areas:

- **Investing for growth:** Advisers encouraged clients to release more equity than they required and to reinvest the surplus cash in an investment product, i.e. Bond
- **Investing for Income:** Instead of recommending an Income Drawdown product, advisers recommended releasing a lump sum. The lump sum was reinvested into an income generating product such as an Investment Bond with a 5% withdrawal to provide a regular income.
- **Inheritance tax (IHT) mitigation:** It was unclear from the files if the recommendation did indeed reduce the clients IHT liability. In most cases no IHT calculations had been undertaken by the adviser to substantiate the advice.

The FSA were concerned that in all of the above examples it was unclear as to how the client would be better off if they agreed to these courses of action. Releasing monies from a property and investing in equity backed investments is a high risk strategy and may be unsuitable for potentially vulnerable clients.

The FSA are currently undertaking a further round of thematic reviews on advisers who have written Lifetime Mortgages over the past 12 months. They are in particular looking at the following:

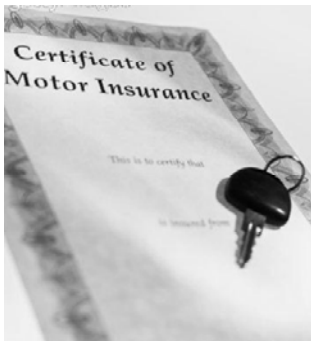
- Do the advisers have the experience and appropriate qualifications to give advice on these complicated products?
- Do the advisers know their client sufficiently well to make a recommendation?
- Do the clients understand the risks of taking out a Lifetime Mortgage?
- Were all the alternative ways of raising finance discounted by the adviser?
- Were State benefits and Local Authority grants discussed with the client?
- If released monies are to be reinvested how this beneficial to the client?
- If monies are to be released for debt consolidation has the client received the appropriate risk warnings?
- Has the adviser justified the amount to be released and not just recommended the maximum amount?
- Has the client recommended a drawdown facility rather than recommending holding the money on deposit?

We are aware that the FSA are currently undertaking these visits and would recommend all Principals and Equity Release advisers to read the Briefing Note BN005 / 2005, full document available at <http://www.fsa.gov.uk/pages/about/media/notes/bn005.shtml> .The FSA will be looking for what action has been taken to address the issues, since the release of the survey in May 2005.

**Advising on Equity Release is a high risk area and as such PCS will be undertaking a review of all firms who undertake this type of business in April 2006. Where appropriate we will shortly be contacting you to make an appointment to review your Lifetime Mortgage procedures and undertake file reviews.**

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### **General Insurance - Thematic visits**



The FSA have announced their thematic visits for this year and General insurance brokers have not escaped the hit list!!

Relevant thematic visits include:

- Client money
- Claims handling
- Payment protection

The FSA will normally contact a firm within a couple of weeks of the proposed visit so you may be getting a call!!

White labelling – this is an excerpt from the recent FSA bulletin

There have been a number of occasions where the FSA have become aware of general insurance promotions which could mislead consumers as to the identity of the insurance provider.

ICOB rules do not require firms to inform the customer of the insurance provider in the promotion. However, where you do inform the customer, your promotion should adhere to the general principle of being clear fair and not misleading. In clear terms it should not state or imply that the distributor is the insurer or the provider of the insurance.

If the promotion for example, a direct mailing includes full product information so that the customer can fill in an application form or ring up and take out the contract without receiving any further information before conclusion then both status and product disclosure rules apply. ICOB4 requires the distributor to give the customer information about itself and ICOB 5.5.5R (2) requires the insurers name to be given in the policy summary. The distributor cannot add its own name to the policy summary.

If you require any further guidance on financial promotion, please contact one of the team

## **FSA proposes regime for SIPPs and other personal pensions**

The Financial Service Authority (FSA) has now published its consultation paper CP06/5 detailing how it will regulate all personal pensions, particularly Self-Invested Personal Pensions (SIPPs), from April 2007.

Under the new regime all those who operate a SIPPs scheme will need to apply for additional permission or authorisation if not already authorised.

### **How will the Regulated Activity's Order (RAO) affect firms?**

The major effect of the change to the RAO is that SIPPs will become regulated under FSMA for the first time in their own right. The operation of the SIPP scheme *wrapper* will be regulated, whereas the previous treatment was to see through the wrapper to any FSMA-regulated investments held within a SIPP and to apply our rules to those investments. Amongst other things, this means that existing operators of SIPPs will need to apply for authorisation by us, if they are not already authorised for other reasons. We understand that there are currently around 100 such schemes.

Actions the FSA will take to ensure consumer protection before regulation starts in April 2007 include:

- Encouraging all firms to adopt regulatory standards prior to formal regulation;
- Monitoring the way SIPPs are promoted;
- Liaising with trade bodies to encourage member firms to behave appropriately.

Additional changes by the Treasury mean that in future there will be no provisions within the pension's tax legislation restricting the types of firm that can operate a personal pension scheme. Any firm wishing to establish, operate or wind-up such a scheme may apply for authorisation and must obtain permission from the FSA before doing so.

The consultation period for CP06/5 ends on 2 July 2006 and final rules will be published by October 2006.

