Back to BASICS

AUTUMN 1996 ISSUE 1

ALAN STEEL ASSET MANAGEMENT

INDEPENDENT FINANCIAL ADVISERS

Nine golden rules

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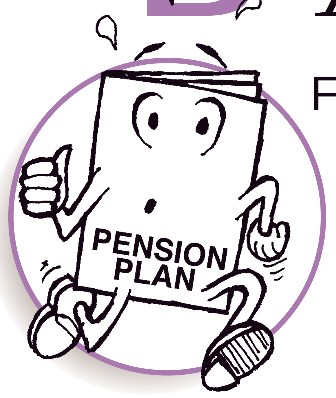

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No will, no way

It has been estimated that two out of three people in Scotland die without a will. This is known as dying intestate, and it's a nightmare for those left behind.

The common excuse for not bothering with a will is the mistaken belief that your partner will get everything anyway. This isn't true. If you are living with a person and not married they have no rights whatsoever. If you are married with children, they automatically receive a large share, and if you are married without children, parents or brothers and sisters have rights to a substantial proportion.

A will is a crucial part of your financial planning, so have one drawn up to reflect what you want. It is the only way it will happen. If you already have a will, have it reviewed, for it may be out of date, and that's almost as bad.

Please note different intestacy laws apply elsewhere in the UK.

Investing for income

Many billions of pounds still lie in banks and building society deposit accounts. People still seem to think these deposits are giving returns on their money similar to the rates available during the 1970s and 80s.

Interest rates have plummeted and are as low as they were over 140 years ago. Most ordinary taxpayers are receiving no return at all once you take off tax and the effect of inflation. Most high rate taxpayers and bank customers are losing each year in real terms.

There are alternatives which are flexible and give far higher returns. Contact us for details.

Shares – up or down?

Debate is intensifying as to whether the FT-SE Index is due for a fall. Will it, however, continue to rise? Is 1996 another 1987? We think not. We think there are good returns to be had from equity investment.

But if you are worried and would like to share in growth from equities without the potential for loss why not consider the many new alternatives such as the protected downside bonds now available which give you opportunities for growth without pain.

What's it all about ASAM?

A word of welcome

In the 23 years that I have been advising people on how to get the most out of their income or accumulated capital, 21 years within Alan Steel Asset Management, I have been struck by the simple fact that money decisions are a continuing mystery to the majority.

So in individual meetings with clients it has been our practice to explain, as simply as possible, what the key issues are, and only then give advice and guidance on how to make the best out of opportunities in tax, investment, savings and protection.

Over the last ten years we have extended this approach to help journalists in various national newspapers, including The Sunday Telegraph, Daily Express, Mail on Sunday, The Financial Times and Scotland on Sunday, achieve a better balance when covering various areas of what has become known as personal finance. For the last seven years or so we have written regular articles ourselves for The Scotsman newspaper, and the feedback from readers suggests our approach is appreciated.

Now that we are in our twenty-first year in business we feel the time has come that the Back to Basics approach should be extended on a formal basis. Hence the birth of this humble publication.

> We think that people want to have a simple structure to their financial affairs, a structure that assesses needs, tax, savings and risk, protects against inflation and strikes a balance between investing for the future, and protecting wealth...

The greatest part of the first issue is dedicated to Pensions. The NINE GOLDEN RULES and FIVE MYTHS is an update of our booklet prepared almost three years ago, subtitled ''Protecting your Pension from the Small Print''.

We realise it will be an onerous task so it is proposed to provide three issues a year. If, however, we feel one area is of great importance to our readers we will prepare a shortened version. If you would like us to cover certain topics, please ask.

We think that people want to have a simple structure to their financial affairs, a structure that assesses needs, tax, savings and risk, protects against inflation and strikes a balance between investing for the future, and protecting wealth should something go wrong in the short term. We believe our role is to add value to your assets and give a better understanding of the various financial decisions you have to make.

Alan Steel
Managing Director

Will tax be fair under Blair?

Previous Labour governments (not seen for 17 years) believed in higher taxation for those with above average income or assets. They also believed in additional tax on investment income.

Estimates vary but it is commonly expected that the top rate of income tax could be 60% which could also apply to profits on investments and tax on death.

Lessons learned in the 1970s suggest it is possible to reduce exposure to tax, with simple restructuring of assets and investments. It is better to arrange now than attempt it when it is too late.

Pepping up your returns

What are PEPs? Put simply, they are entirely tax free investments mainly in a collection of shares. They are not tied to any term. They are ideal for patiently building a tax free nest egg to draw untaxed returns to boost spending in future years.

Those who do not yet have PEPs should consider their merits now. Those who do should check their performance. If you do this and you are unhappy, do not just dump them. You can transfer to a better performing PEP while still retaining the tax free status that is so valuable.

Nine golden rules and five myths about pension plans

Protecting your pension from the small print

1.Why have a pension plan at all?

Leaving aside for a moment the various types of pension plans available, why bother in the first place? Given the various criticisms of pension plans, including the costs involved, why not save for your future like many others in bank or building society deposits?

The straightforward answer is the substantial tax benefits coupled with the advantages that accrue from the contractual nature of a pension plan. Press criticism of costs or charges is overdone, as these can be no more than in any other investment and, in any case, the tax benefits heavily outweigh any charges made.

The tax benefits are -

i) Full tax relief on contributions made at your highest rate.

ii) No tax is paid on income or profit earned in the pension fund as it grows.

iii) Substantial tax free benefits are available when you retire, or die.

The law of contract also protects you. If the Government brings in changes reducing the impact of tax or present advantages, they do not impact on existing policies.

Over a 20 year period, a higher rate taxpayer investing £1,000 per annum in a deposit paying 6% after tax, will build a fund of only £39,000. The same investment in a pension plan will build a fund of over £130,000, allowing for charges.

Rule 1
Always use tax concessions to boost your savings.

2. How much should I put aside and when should I start?

The simple answer is as much as you can afford and the earlier the better. There is no doubt that people today want to retire earlier, and whether or not you do retire early you will be in a similar position to those retiring today - the majority have insufficient pension income.

It is also the case that many retiring in future cannot rely on state pensions being in place to prop up their income. Inheritances, too, are under threat because of long term care costs.

Most underestimate how much accumulated pension funds will be needed until it is too late. An individual goal-setting review can solve this. For example, a 40 year old male wishing to retire at age 55 looking for the equivalent of £15,000 per annum private pension in today's money, assuming 5% inflation, should take note of the following:

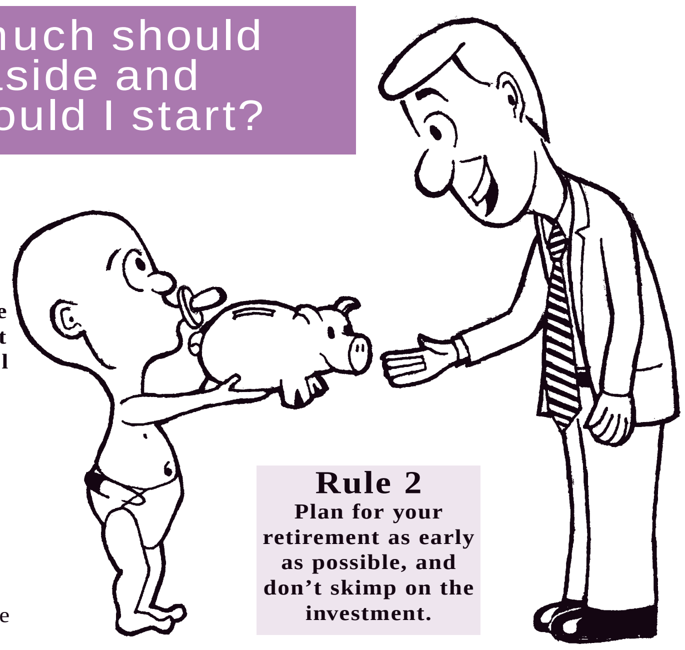
i)The average inflation rate since 1945 is 7% per annum.

ii)The income at 55 would be £30,000 per annum.

iii)At current interest rates, the fund needed would be at least £400,000.

iv)An additional £200,000, at least, would be required to provide inflation protection and protect a widow in retirement.

Compound interest helps to work in your favour. The earlier you start to provide a target pension, the less you require to put away.



Rule 2
Plan for your retirement as early as possible, and don't skimp on the investment.

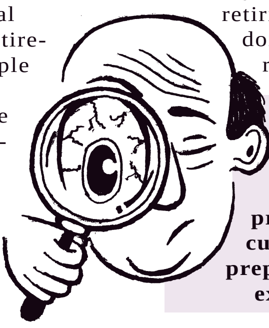
3. I am in a company pension scheme which I believe gives full benefits. Why should I bother looking further?

Probably three or four people in 100 retire on full allowable pension benefits.

Most will retire on only a pension of less than a third of their final income before retirement. Fewer people today spend all their working life with one employer, and moving around loses benefits.

Even the best schemes aiming to provide a pension linked to final salary do not take account of bonuses, overtime, or benefits in kind. The majority of people retiring today are doing so on early retirement, and not out of choice. It is likely that, increasingly, there will be fewer final salary pension schemes because of changes in pension laws, and onerous responsibilities on employers.

All of this eats into your pension entitlement. But the law allows you to plug these gaps either by providing extra full tax relief on further contributions, or in building tax free investments providing tax free income to boost spending in retirement.



Rule 3
Be absolutely sure what your pension scheme provides in all circumstances, and be prepared to put away extra money.

4. If I die before retirement, what happens?

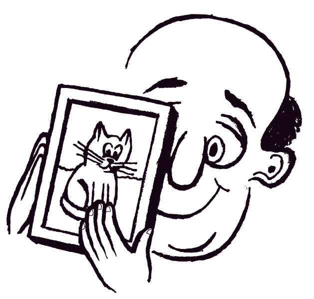
Most people wrongly assume that, if they die before retiring, the full value of their investment will be returned to their family and there will also be adequate life assurance protection. Most of the time this is just not true.

Many thousands of private plans exist which, on death, return only the contributions made, or with interest added only at the rate of 4% per annum. The returns on death from such plans are far less than the actual accumulated values.

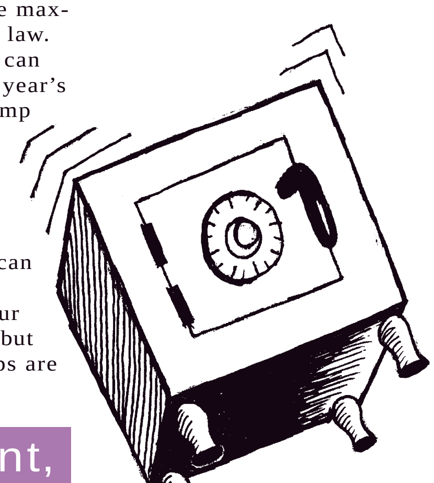
This is especially the case for policies taken out before the late 1980s. The difference in returns can be substantial, for example, only £20,000 rather than a value of over £100,000.

Many pension schemes provide, on death, only a return of personal contributions without interest, and a lump sum less than the maximum allowable under law. For example, teachers can expect as little as one year's salary paid out as a lump sum on death, and the husbands of female teachers receive little by way of widower's pension.

Fortunately, steps can be taken to secure full value for money to your family on your death, but only if the correct steps are taken.



Rule 4
Check that, if you were to die before retirement, your family will receive full value for money from your various contributions.

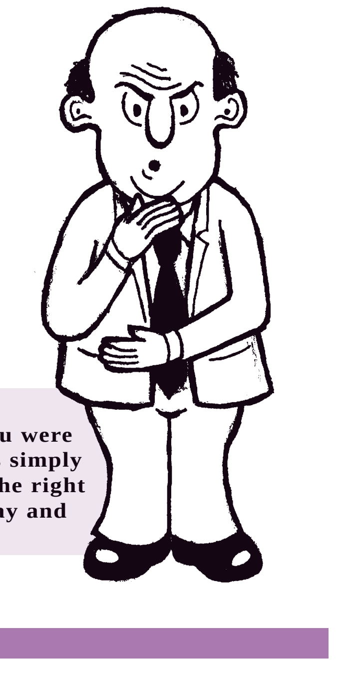


5. If I die before retirement, do the returns go direct to my family?

Most individual pension policies taken out before 1988 are designed to be paid on death direct to your estate. This is also the case for the majority of cases who have left employers with final salary pension schemes, and who have transferred pension funds to individual policies.

This means that payment to the correct members of the family will be delayed, especially if no will is in place and, in extreme cases, tax currently at 40% would be paid on the proceeds.

Even in the case of more recent plans, the proceeds may go to family members you do not intend to benefit. It is still possible, and indeed prudent, to take steps to amend your existing policies to ensure, in the event of your death, that the proceeds go to the rightful beneficiaries, thus also bypassing delays and taxation.



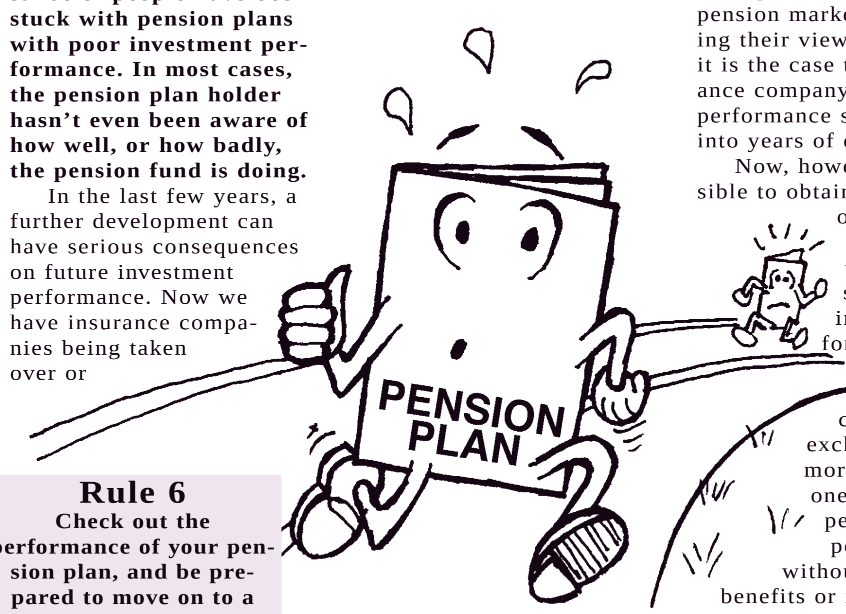
Rule 5
Make sure that, if you were to die, the funds pass simply and immediately to the right people avoiding delay and taxation.

6.What if I have a poorly performing pension plan?

For too long, many thousands of people have been stuck with pension plans with poor investment performance. In most cases, the pension plan holder hasn't even been aware of how well, or how badly, the pension fund is doing.

In the last few years, a further development can have serious consequences on future investment performance. Now we have insurance companies being taken over or merging with companies who were previously keen on the pension marketplace, changing their views. Sometimes it is the case that an insurance company's investment performance simply falls into years of decline.

Now, however, it is possible to obtain cash values of plans at any stage and, therefore, possible to assess investment performance. Poorly performing plans can be exchanged for a more appropriate one with better performance or potential, without losing tax benefits or incurring heavy costs.



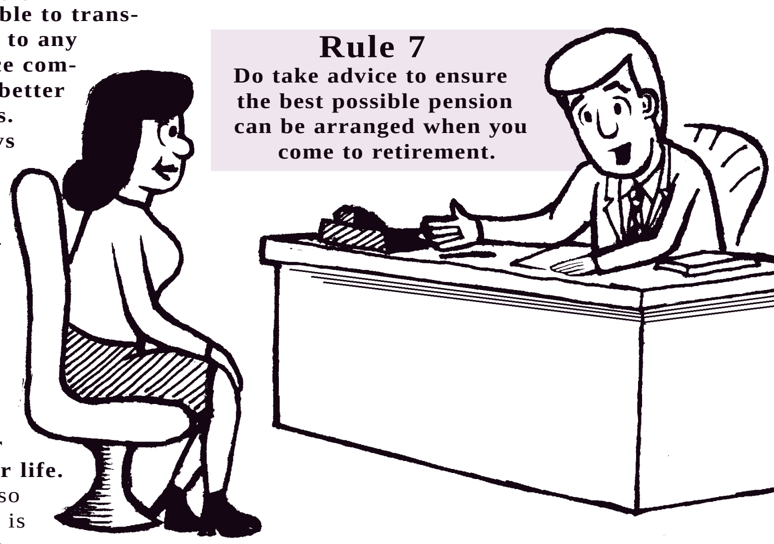
Rule 6
Check out the performance of your pension plan, and be prepared to move on to a better performing one.

7.I have private pensions. When I retire, do I have to take a pension from my existing insurance companies?

No! For many years, it has been possible to transfer your funds to any other insurance company offering better income returns. This has always been a highly competitive marketplace, and it is possible to increase pension returns by as much as 10% to 15%. This increased income will benefit you for the rest of your life.

It should also be noted that it is now possible to increase pension income for smokers, and for people in ill health.

Furthermore, if you are in a position where different pension funds relate to separate employments, or periods in your working life, care must be especially taken to ensure you maximise your pension income from the whole of your pension funds.



Rule 7
Do take advice to ensure the best possible pension can be arranged when you come to retirement.

8. If I need my tax free cash at retirement, are there any other options available on how I take my pension?

Yes, very much so!

You have the choice of buying a conventional annuity, which means you select a fixed formula of benefits which, once selected, cannot be changed. Or, you can purchase initially an income withdrawal plan, which provides a variable income at your selection, allowing you to defer the purchase of the fixed formula income until later, as suits your circumstances.

Conventional annuity

Most people are offered, and accept, a standardised annuity, commonly paid monthly, with level payments, guaranteed for a minimum of five years, with little or no widow protection. It is crucial to understand the range of options open to you, and how best to use them to select the most appropriate one for you.

Income withdrawal plan

They were designed following the sharp interest rate falls of late 1992 which reduced annuity rates heavily. These plans allow you to vary the income level you take from your fund within a wide range, and allow you to defer buying a conventional annuity until it suits you or, at age 75 at the latest. Sales are mushrooming, but too high a level of income in early years can reduce the fund to the extent that income can fall substantially after only a few years. Take great care and take good advice first.

Rule 8
Make sure with good advice that the annuity system you select properly protects you in retirement.

Five myths

1 *It's better to use endowment policies*

They offer no tax relief and are taxed internally. Also, premiums have to be paid fully throughout the term to secure value for money. Pensions give tax relief, grow tax free, and are flexible.

2 *You have to pay into pensions from income*

This is not the case. In most cases, lazy capital, such as deposits, can be used to top-up pension contributions from time to time, picking up tax relief into the bargain.

3 *I have to pay pension premiums throughout the term*

No! One-off contributions can be paid at any time, as long as tax relief is available. Even regular policies can be effective if paid for only five years.

4 *The charges are too high*

In the bad old days, insurance companies paid commissions on plans to age 70 or 75 when, in reality, benefits were taken at age 60. It is possible to reduce charges enormously to the extent that they are no more than other less effective investments.

5 *It is better to wait until I'm older before starting a plan*

No, it is the opposite. A 30 year old male paying over five years only a net £740 each year, at age 60 will have a fund of £73,000, assuming only 10% per annum growth. A 40 year old male would have to pay the same payment for over 21 years to produce the same fund.

9. If I do not need the tax free cash at the outset, is there another option?

Yes! With annuity rates still some 15% below mid-1992 levels, it makes sense to defer the decision to purchase a conventional annuity, which must be done by age 75.

The best answer for those people with other liquid or invested assets, who may be in receipt of other income, or particularly higher rate taxpayers, is to transfer the pension funds into a phased retirement plan.

Such a move allows you to create, at any time, a top-up income by drawing out some of the pension fund to suit your needs. The "income" consists partly of tax free cash, thus reducing income tax heavily. It also protects the full value of the accumulated pension funds in the event of death. If this happens before age 75, the entire fund passes automatically tax free to your partner or family without any tax.

These plans are more efficient than any alternative, and you can tailor-make the investment strategy to suit you. You can still take tax free cash and purchase annuities or income withdrawal plans when you require to.

Rule 9
Consider the advantages of drip-feeding income in retirement, tax efficiently, and maintaining your capital in a wholly tax free environment.

Summary

These nine golden rules and five myths represent questions or points raised by clients over the years. Pensions are a complex subject, but with simple answers once you know what's what. You require specialist assistance which can only come from experienced independent financial advisers.

Do you need a higher income?

On page one, we point out that deposit accounts are now providing returns that are pathetic compared to rates available as recently as 1992.

Since then interest rates have plummeted.

Today, ordinary tax payers are getting returns on deposits which in many cases are only a quarter of what they obtained less than five years ago.

While this has been going on, the lower interest rates have also reduced substantially annuity rates which turn pension funds into income at retirement.

One big question is will we see an early return to the higher interest rates common over the last 20 years or so? We think not.

Indeed, eminent economists believe further small cuts of interest rates are on the cards next year.

Also, it is widely believed that we are in for quite a number of years of low interest rates.

There has never been a better time to recognise these facts.

Although inflation in our country has also fallen heavily, people, especially in retirement, need to invest in a manner to provide higher returns, above inflation, and to reduce exposure to tax.

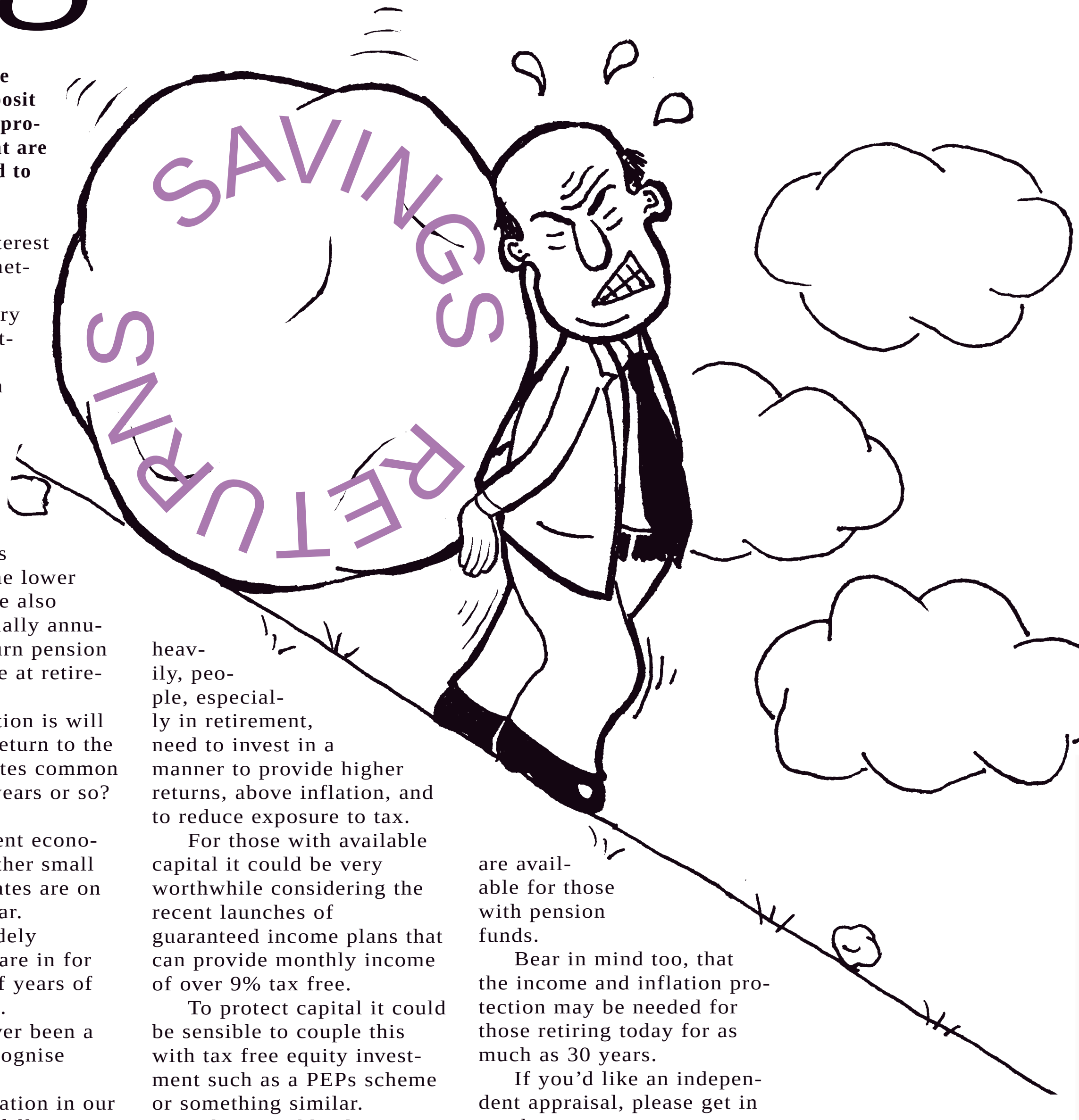
For those with available capital it could be very worthwhile considering the recent launches of guaranteed income plans that can provide monthly income of over 9% tax free.

To protect capital it could be sensible to couple this with tax free equity investment such as a PEPs scheme or something similar.

Other sensible alternatives are available for those with pension funds.

Bear in mind too, that the income and inflation protection may be needed for those retiring today for as much as 30 years.

If you'd like an independent appraisal, please get in touch.



Who are we?

Alan Steel Asset Management was formed in Linlithgow in 1975. Over the years, we experimented with additional offices in Glasgow and Edinburgh, but found the attraction of having everybody under one roof in a country environment overwhelming. Being in the middle of Scotland, based in a small town, has many advantages, the principal one being able to take a considered view away from the madding crowd.

Twenty-one years ago, there were only two of us, and gradual increases over the years sees us now with 28 staff, the bulk of whom are providing support or service.

There are now six key advisers, including directors. Alan Steel, an independent adviser for over 23 years, leads the team. His skills lie in overall financial planning and working closely with personal finance journalists.

Stan Chuchla has over 25 years experience in the field. Like Alan, he could be described as a personal finance general practitioner.

Ken Wilson, on the other hand, has particular expertise in investment planning and pensions.

We extended our tax planning expertise by bringing in Frances Sinclair, a Chartered Accountant and Associate of the Institute of Taxation. Steve Forbes, who joined us at the same time, brought with him wide financial planning experience, including offshore tax planning. Graeme Currie, our latest key recruit, has substantial expertise gained with a national firm of employee benefit consultants, and advises in all areas of pensions and investment.

Our role as advisers, supported by our service staff, is to take collective expertise and apply it to the advantage of our clients, new and old. We act solely for you, not for insurance companies or other financial institutions, and we have gained, over the years, a reputation for quality financial advice, delivered in a friendly, easy to understand, manner.

If this sounds attractive to you, please get in touch.

Services we provide

- **Review existing financial planning.**
- **Prepare goal setting strategies for investment protection.**
- **Reduce tax and increase investment returns.**
- **Invest for income and capital growth.**
- **Health, life assurance and private medical insurance.**
- **Planning for retirement.**
- **Simplify personal and corporate pensions decisions.**
- **Business protection packages, employee benefits, health and life assurance.**
- **Advice on off-shore investment opportunities for UK residents and ex-patriots.**
- **Use of trusts to save tax.**
- **Tax compliance services for self assessment and tax returns.**
- **School fees planning.**

What can an IFA do for you?

Today, it is still the case that most people don't make the most out of their financial affairs. Perhaps they are too busy, unsure who to talk to, or just confused. Whatever, the reason, the inefficiency can be seen in various statistics. A recent survey indicated only 3% of retiring people do so with maximum pensions. Almost half of the public thought that putting £50 a month away would buy a pension, after 30 years, of £200 a week in today's money - IT WILL NOT.

It is also estimated that nine people out of 10 pay more tax than they should. Just as many are underprotected and wholly unprepared in the event of sudden death or serious illness. Why?

An independent financial adviser, despite what is often perceived to the contrary, is the best person to help you establish your financial goals to achieve the results you want at such times. Their job is to review your present position, establish meaningful goals, assess what adjustments are needed, what new additions are necessary, and then help you continually review progress.

For us to be able to do all this, we need to keep abreast of changes and developments in all the various tax laws, product innovations, stockmarkets, interest rates and so on.

Obviously, such a review and continual support and research cannot be free, and neither should it be. The costs or changes, however, must be fair to both parties, because the only successful long term relationship is a WIN/WIN.

Much has been made about fees versus commission. At the end of the day, it doesn't matter what basis is agreed, as long as a fair price is charged for a superior benefit to you. These benefits should outweigh any costs involved, and they do.

If you would welcome a fresh appraisal of your overall financial affairs, please ask.

REMIND ME ONCE MORE OF THE AMAZING TAX ADVANTAGES

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