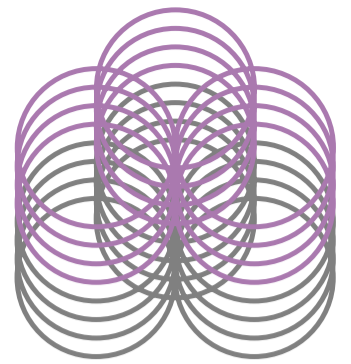


Back to BASICS



PENSION SPECIAL:
Complex issues
made easy

page 1

PENSION SPECIAL:
Flexibility and
security

page 2

PENSION SPECIAL:
Slicing the
salami

page 3

PENSION SPECIAL:
ASAM's award
winning team

page 4

AUTUMN 1998 ISSUE 3

ALAN STEEL ASSET MANAGEMENT

INDEPENDENT FINANCIAL ADVISERS

Pensions Income Withdrawal

Perhaps the next scandal in the wings

Is it any surprise that the public are bamboozled by Pensions? Since 1961, there have been over 130 MAJOR LEGISLATIVE CHANGES introduced by successive Governments. Staggeringly, over 90% of these changes have been forced through since 1986.

If you add to that number the many hundreds of Inland Revenue changes of practice and the continual product development, it is little wonder the public and many traditional professional advisers are so confused that many have

selected, or have been sold, the wrong product. And, of course, there have been, on the back of all of this, a few mis-selling scandals and probably more to come.

An increasing number of industry experts, as well

Don't even consider it until you know the answers to these ten questions!

as actuaries and academics, are concerned about the recent development of the Pension Income Withdrawal Plan - perhaps the next scandal in the wings.

Working on the basis that it is better to forewarn the public about the dangers of this plan, rather than wait to pick up the pieces, we have put together the following ten questions and answers that should be digested before you decide how best to organise your income in retirement. The answers represent our own independent

view, but it comes on the back of many years of assisting thousands of clients to plan and prepare for an effective financial retirement. Every week, we assist leading financial journalists in preparation of their articles on various financial planning issues. If, after reading these answers, you feel we may have the answer for you, please get in touch.

Alan Steel: Managing Director of Alan Steel Asset Management.

1

Pension Income Withdrawal - what is it?

Sometimes, it is known as Income Drawdown. Some insurance companies will give it a brand name but, despite the name given to it, it always works exactly the same way.

It is a flexible way of taking a regular income from your accumulated private pension fund, whether you have retired or not. It was designed to save you having to provide the income by buying with your pension fund a Conventional Annuity which, once purchased, could not be altered in any way - a fixed income formula for life.

Unless you have an unusual occupation, such as a footballer, you must wait until age 50 before being eligible to take income from your accumulated private pension fund. So, you can have the option of having a flexible income available under Pension Income

Withdrawal from age 50 onwards. But, unless you have done so earlier, this must be exchanged for the fixed formula Conventional Annuity, under present law, at age 75.

Under the majority of private pension plans, once you take the tax free cash sum available, you must then take an Income Withdrawal or purchase a Conventional Annuity. If you do not, at the time, need the tax free cash sum, there are other options explained later.

A FLEXIBLE way of taking a regular income

Until 1993, for the majority of private pension plans, if you needed to take the tax free cash from age 50 onwards, you had to purchase, with the rest of the pension fund available, a Conventional Annuity. There was no other choice.

That year, one insurance company broke with tradition and made available to its customers an income from their pension fund, without the need to purchase, at that time, an annuity. They were followed by another insurance company wishing to do likewise. However, they decided to seek Inland Revenue approval before making the option available

How long has it been available?

2

to the public. It should be noted that all pensions are subject to Inland Revenue rules and approval so they are, in effect, covered by tax law.

The Inland Revenue regarded this development as major, with potentially serious consequences regarding the future financial well being of pensioners, especially if income levels fell in retirement. Therefore, they set maximum and minimum income levels, new procedures and laid down the tax position, particularly on death of the pensioner before age 75, or the previous purchase of a Conventional Annuity.

The Pensions Act of

1995 ensured all new Pension Income Withdrawal Schemes followed the Inland Revenue rules. At the beginning of the plan, and every three years thereafter, the Government Actuary Department (GAD) sets the maximum and minimum levels for income withdrawal for each year of age for men and women, until age 75.

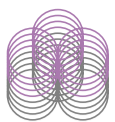
These income levels reflect the long term gilt yield (long term interest rates) at the purchase date and at the three yearly review.

There are, however, no Inland Revenue rules or guidelines relating to the investment strategy of the pension fund from which the income is provided.

UNTIL 1993, for the majority of private pension plans you had to purchase a CONVENTIONAL ANNUITY

SECURING YOUR FUTURE

Alan Steel Asset Management Tel (01506) 842365, Fax (01506) 845074



3

Why was it developed?

Although we have all experienced fluctuating interest rates over the last 25 years or so, either as building society investors or mortgage holders, we would have recognised there was a cycle. Interest rates went down and then back up again in only a few years.

Conventional Annuities, until recently the only option of turning an accumulated pension fund into income, rise and fall, depending on long term interest rates, which are not as volatile as short term interest rates. A long term interest rate has been

ECONOMIC upheaval

Industrial Age, there is, believe it or not, a surplus of cash in the World. Interest rates and inflation have been forced downwards and have fallen to a level not seen for many, many years. Some experts expect them to fall further, although the major downward movement is over.

This has pushed long term interest rates down quite heavily. Simultaneously, the workplace has changed dramatically. The end has come for the majority working in the same company for life and having a Final Salary Group Pension Plan. More and more people are forced into private pension provi-

sion. Careers are changing, never mind employers.

Also, as a result of the economic upheaval, most people are retiring earlier, some as young as age 50, although the majority in their mid-50's to 60. Annuity rates have fallen sharply since the early Nineties, as the long term interest rates fell. At the same time, an increasing number of people are requiring income to fund their full, or part-time, retirement at earlier ages. This is an unfortunate double whammy - a double fall of income levels.

To give a simple example, in October 1990, a 65 year old male could have purchased a Conventional Level Income Annuity of £20,000 per annum with £140,000 of pension fund. Today, a 65 year old male requires a pension fund of around £300,000 to buy the same income in real terms.

So, flexibility was needed to provide income and defer the purchase of the Conventional Annuity until, hopefully, better times and higher rates became available.

most PEOPLE are retiring earlier

somewhat dampened down in its movement by the fact that short term interest rates rose and fell over short periods.

Because of changes to the global economy forced upon us by the Information Age, heralding the final death throes of the

4

What about the Conventional Annuity?

So obviously there was a need to find alternatives to the fixed formula Conventional Annuity, on the back of falling interest rates and early retirement. But while flexibility is desirable so is security, especially when it comes to retirement income.

One thing is certain. The purchase of a Conventional Annuity offers security because although, once it is purchased, it cannot be changed; its income cannot fall. However the manner in which people have purchased annuities has been seriously flawed.

Normally the insurance company responsible for the accumulated pension fund, when asked for an annuity quotation shows the following:

- a) A pension for the pension holder only
- b) Payable monthly
- c) On a level income basis (doesn't increase)
- d) Guaranteed for a minimum period of five years (If you die before five years the five year total income is still paid)

A number of questions arise from all of this. What about pension provision for my marriage partner? And if I provide this, and she dies before me, do I lose this bit of the pension fund used to guarantee her income? If I buy an increasing pension instead, to take care of future inflation, if I live for many years in retirement, can I afford the substantial drop in income now? Why don't the insurance compa-

nies offer ten year guarantee periods automatically, given the loss of pension income, after tax, is minimal? These are only some of many questions.

Under the Conventional Annuity all of the income is subject to income tax, but if the pension holder dies the pension fund is retained by the insurance company, apart from any net total income due under

the manner in which PEOPLE have purchased annuities has been seriously flawed

the guaranteed period. That is why it is always worth considering a ten year guaranteed period - the maximum guaranteed period.

If you are retiring or part retiring early, and if you think long term interest rates are not going to fall further, then it probably doesn't make sense to buy at this stage a Conventional Annuity. Older first time buyers of pension income seeking security, and needing their tax free cash, may prefer the Conventional Annuity chosen with the assistance of expert independent help.

Clearly, on the face of it, if Conventional Annuity rates are falling, as they have done over the last few years, if the decision process in buying an appropriate Conventional Annuity is fraught with uncertainties and, as people are retiring earlier, then a flexible alternative is desirable.

But, the Income Withdrawal Plan has many drawbacks. And these are:

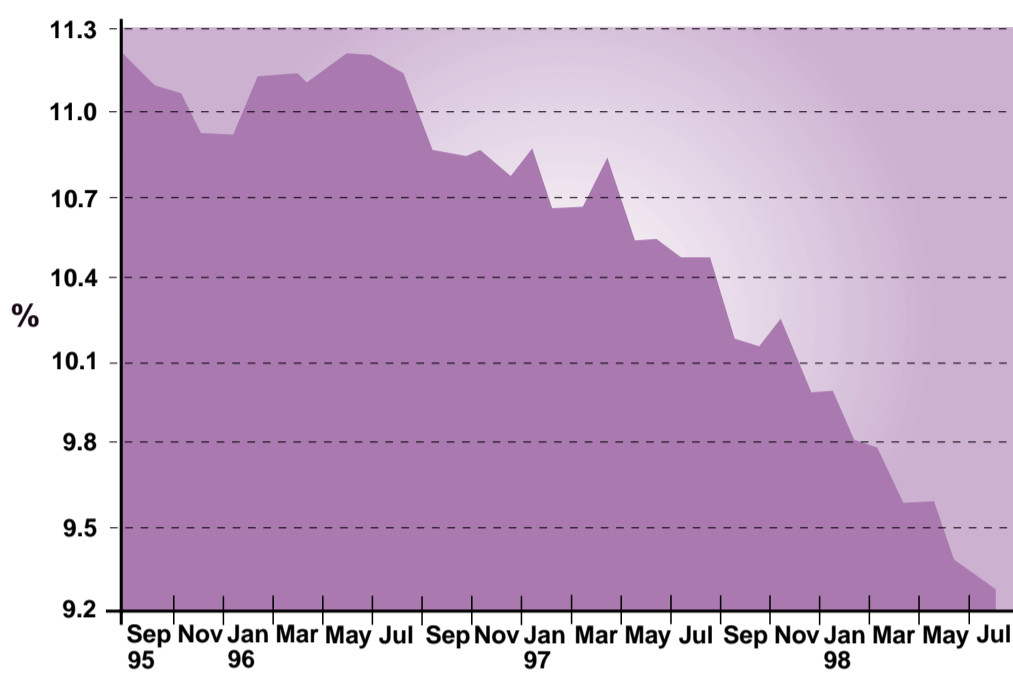
- a) The standard type, offered by individual insurance companies, means once you take your income (having taken your tax free cash) you cannot move your investment to any other pension provider. If the insurance company's investment performance is poor, you are stuck with them until you purchase an annuity.

- b) The charges, including commission or its alternative, can be unacceptably high - as much as 6% initial charge - thus requiring higher investment returns to compensate.

- c) The maximum and minimum income levels can fall every three years if long term interest rates fall and investment performance isn't good enough. We are already seeing those requiring maximum income facing real income falls of 25% or more in only the last three years. We warned of this over two years ago in *The Financial Mail on Sunday*, *The Sunday Telegraph* and elsewhere.

- d) The majority of existing Income

Annuity Rates September 1995 - July 1998



Annuity rates per £10,000 purchase price, level, single life, no guarantee for a male, 60 attained. Source: Annuity Direct.

5

So why the concerns about Income Withdrawal?

Withdrawal Plans are linked to With Profit policies where returns, in the last three years, have been insufficient to combat falling interest rates and heavy charges. This approach is unlikely to reverse the trend in the future.

- e) The taxation consequences are dire. The income taken is liable to Income Tax at your highest level. On death, the residual fund is taxed at 35% before the balance goes to your estate, where it could suffer Inheritance Tax then, or later, at a further rate of 40%.

- f) We also have evidence

you are STUCK with them until you purchase an annuity

of people, fearing that the tax free cash facility could be removed by Government legislation being persuaded to take it early, thus triggering a taxable income not

required. Furthermore, the subsequent investment of the tax free cash creates further unnecessary tax. As the tax free cash facility is enshrined in pension law we do not believe it will be removed.

But, how do you avoid (until age 75) the necessity of buying an inflexible, inappropriate annuity, without having to leap into the tax inefficient, highly charged inefficient income withdrawal. There is another answer which predated the income withdrawal development and is largely ignored. It is the Phased Retirement Plan.

6

What is a Phased Retirement Plan?

In 1988, the Government introduced the Personal Pension Plan as a simple alternative to the Retirement Annuity policy taken out by individuals who are self employed, or who are not members of any pension scheme. It was also envisaged it would be suitable for groups of workers whose employers could no longer afford Final Salary Pension Schemes.

Contributions made regularly to build the Personal Pension Plan would be subject to maximum levels, but there was no maximum pension level on the way out. Tax

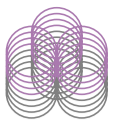
free cash, available with a pension from age 50 onwards, would be limited to 25% of the total accumulated fund at the time.

Transfers can be made from previous pension plans, such as Retirement Annuities, but, in the case of transfers from Occupational Pensions, they are subject to restrictions, including the level of tax free cash. Again, there is a maximum age of 75 when the residual pension fund, after tax free cash, must buy a Conventional Annuity.

Because the Personal

Pension Plan can be taken out as 1,000 different segments, rather than only one policy, this gives great flexibility in cashing segments to provide a tax effective income, leaving the bulk of the pension fund intact and free of tax. Year by year, by repeating this exercise, your income can be provided with low levels of tax, it can vary enormously depending on your circumstances and, if you die before age 75, with a substantial fund remaining, that fund can be passed free of all taxes, including Inheritance Tax, to your family, as long as a Simple Trust is added to the plan.

the Personal PENSION Plan can be taken out as 1,000 different segments



7

So how does it compare to Income Withdrawal?

As we have seen earlier, Income Withdrawal is the only alternative to the Conventional Annuity when you must have the tax free cash sum. Once purchased, and you now know the dangers, the income taken must be within minimum and maximum levels laid down, and varied every three years, by the Government Actuary Department.

No annuity is purchased until you buy a Conventional Annuity, all income is taxed, charges can be high, investment performance poor and it is extremely tax ineffective.

If you are in a situation where you require some income to top up other income from part time earnings, deposit interest, investments or State pensions, the Phased Retirement Plan may be ideal for you. Also, if you are in serious ill health, it may be a more useful option than buying any form of annuity.

Imagine the pension fund represented by the Phased Retirement Plan as a giant Salami. Each slice you cut off to provide income has one quarter tax free. The other three-quarters must be used to purchase a small conventional annuity, so as to reflect your circumstances. After you pay tax on the small annuity, your spendable income is the net amount plus the tax free cash sum. The rest of the Salami (the pension fund) is left to roll up tax free, protected by trust against Inheritance Tax.

Let's look at a current example. A 60 year old male, 40% taxpayer, has other assets and income and doesn't require his tax free cash sum now, as he realises it will have to be invested making it liable to further taxation. However, he has been persuaded to go for Income Withdrawal on a minimum income level basis. His total pension fund is worth £440,000. After he takes his tax free cash, the remaining £330,000 pension fund provides a income of just under £9,820 gross. After 40% tax, he is left with less than £5,900.

However, his tax free cash has to be invested in taxable areas. It also loses Inheritance Tax freedom, as does his pension fund. Should he die before age 75 or previously purchasing an annuity, 35% tax will be deducted before the balance of the pension fund falls into his estate. This, of course, would be liable

to Inheritance Tax also.

With the Phased Retirement Plan, only £20,000 of segments need be cashed providing an after-tax income of £5,900 this year, £900 of which will form a repeating net annuity. The remaining

Imagine the PENSION fund represented by the Phased Retirement Plan as a giant

£420,000 in the pension fund can continue to grow tax free, protected by trust. He can top-up his future income year by year from his growing tax efficient fund when he requires to.

On the other hand, no income need be taken out until his circumstances alter. Phased Retirement Plans can also have unrealistic charges, but fair minded, independent advisers are usually happy to reduce the charges to a level appropriate to those of Conventional Annuities.

It has been calculated by experts that, over the last three years, a maximum

Income Withdrawal Plan would have to have grown between 15% to 19% per annum to have matched the income from a

Conventional Annuity. It has also been estimated that Phased Retirement Plans providing similar levels of income, for higher rate taxpayers, need only have grown in fund value by less than 7% per annum.

Phased Retirement Plans are suitable as self-invested Personal Pensions, allowing the pension holder to select his or her own investment strategy. They are also ideal for Controlled Risk investment where the downside risk from equity markets is limited.

10

How should I plan my retirement income?

As you can see, the changes which have led to falling interest rates, an increase in private pension provision and the substantial increase in early, full or part retirement, cause enormous difficulties for people seeking income from their pension plans. This new situation has exposed also the inefficiency of most pension plans, designed in an entirely different economic environment.

The following are some helpful guidelines -

a) For the younger person looking to plan for effective retirement 10 to 20 years hence, and recognising that earlier retirement is here to stay, perhaps it is time for them to consider savings methods other than pensions so that their tax efficient income is not locked into low interest rates in future.

b) For those faced with imminent retirement, including many thousands of Baby Boomers, now in their early fifties, it is still not too late to embrace the wider concept of retirement "income". For those who need little extra income, or none, at present, either you should leave the pensions intact for the time being, or switch existing plans to Phased Retirement, as described in Section 7 and 8.

If you have other investments, and do not see the sense in taking your tax free cash to reinvest less

efficiently, consider removing tax effective income from the other investments, making full use of the opportunities with Independent Tax, annual Capital Gains Tax exemptions, and the tax free income facilities from PEPs (apart from other opportunities). This allows you to top up income efficiently using pensions within the Phased Retirement Plan.

this new SITUATION has exposed the inefficiency of most pension plans

c) If you must take tax free cash and are willing to take an income below the maximum level offered by Conventional Annuities, then a sensibly charged, flexible investment, Income Withdrawal Plan, with an income set below the maximum level looks like the right option.

d) If you do need the tax free cash and you wish absolute security of income over the years ahead, especially if you are 65 or over, the Conventional Annuity is probably the best bet. But, do ensure that very careful thought is given to guaranteed periods, spouse protection and rising income levels. Perhaps With Profit Annuities, which give the prospect of rising income, offer the best Conventional Annuity option.

8

Is there any other alternative?

Like me, you have probably noticed that there always seems to be three alternatives in life. This time, unfortunately, there is a fourth, but it is actually quite simple. Do nothing!

Often, when we take enquiries from confused pension fund investors, they assume that if they've retired, or reached a certain age (much less than age 75), they have to make a decision on drawing income and taking benefits. If you do not need the income, you do not need to take any.

Equally, it should be noted you do not need to retire to draw some income. You can have earned income and pension income simultaneously.

However, if you have accumulated pension funds and decide not to draw benefits, it is still worthwhile ensuring:

a) That the investment performance meets your requirements. For example, you may wish to protect your pension fund from loss by transferring to a Controlled Risk plan which protects against falling stockmarkets.

b) That the amount paid on death is equal to the

current fund value. Many thousands of plans still exist with death returns equal to the total of premiums paid, either with no, or little, interest addition.

c) That the full fund value is not just paid into your estate. Adding a Simple Trust will ensure this doesn't happen and that the fund goes entirely tax free (including Inheritance Tax) to your family.

DO nothing?

9

Is Income Withdrawal suitable for any circumstances?

It is obvious that most people with Income Withdrawal Plans have not appreciated the tax inefficiency of the plan when viewed in a total situation - the exposure to income tax, the loss of Inheritance Tax protection, the unnecessary exposure to further tax on the reinvestment of the tax free cash sum, and the special tax rate of 35% when the residual fund is returned to the estate on death.

In addition, Income Withdrawal is still affected by falling interest rates much in the same way as annuities are, if you defer their purchase.

There is also a degree of inflexibility to the extent that, if you purchase an insurance company's standard withdrawal plan, you are locked into that company's investment performance, good, bad or indifferent. Then, of course, there are the high charges applied to the majority of plans which already exist.

Our view is that if you are retiring early, and you must access the tax free cash sum, then it is probably better, at this stage, to go down the Income Withdrawal route, rather than lock into the Conventional Annuity.

However, we would recommend the following

ACTION

action:

a) Do not take the maximum income withdrawal if you wish to have the opportunity of rising income over the years ahead. Some experts are already suggesting an income level, at best, equal to about 70% of the maximum income levels available.

b) Only accept an Income Withdrawal Plan where the initial charge is reduced to at least one third of the amount typically charged. This will go a long way to help the investment return in future of the plan you take out.

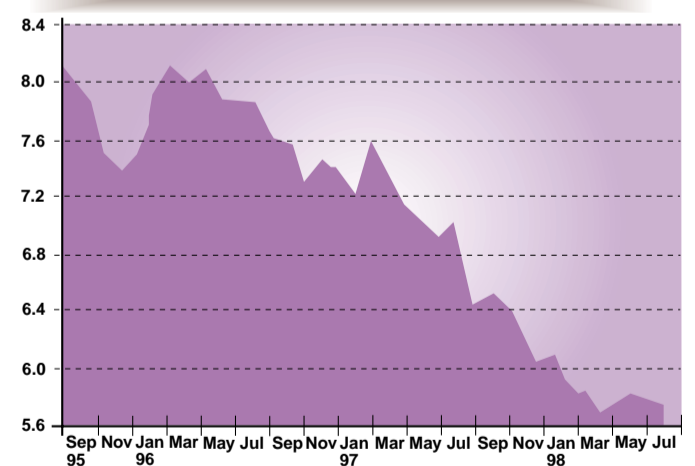
c) Do not accept high levels of With Profit investment linking within your plan,

because the investment returns are unlikely to be high enough over the years ahead to maintain your income level, never mind increase it.

d) Look for either a Self Invested Income Withdrawal Plan so that you are not locked into the investment performance of any one financial institution, or insist on a plan which allows free switching within it to a range of fund managers with proven past investment performance.

Perhaps, however, it makes sense to draw your retirement income from a variety of areas.

UK 10 Year Benchmark Bond Yields
September 1995 - July 1998



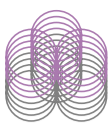
Source: Bloomberg.

Design your income with Alan Steel Asset Management

Alan Steel Asset Management have been providing independent financial advice to a wide range of clients since 1975, helping them prepare for effective retirement.

Ours is a highly personal service which we believe is the best way for clients to make the most of their personal financial affairs as they approach retirement.

If you would like to discuss with us how we could be of assistance to you, whether your retirement is imminent or not, please call us today.



Who are we?

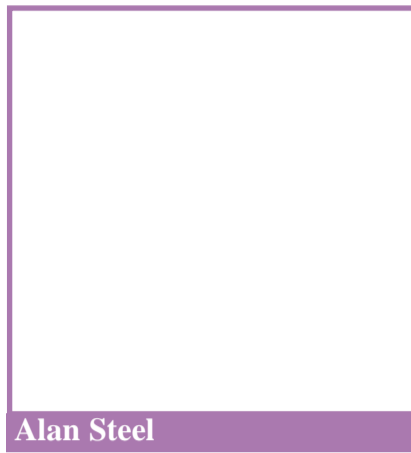
The key players in the team are led by Alan Steel based in Linlithgow, in the middle of Scotland, which provides excellent communications and great quality of life. The former is important for serving our clients all over the UK and the latter ensures that we have a very low staff turnover.

Both factors are very important in providing clients with outstandingly reliable service.

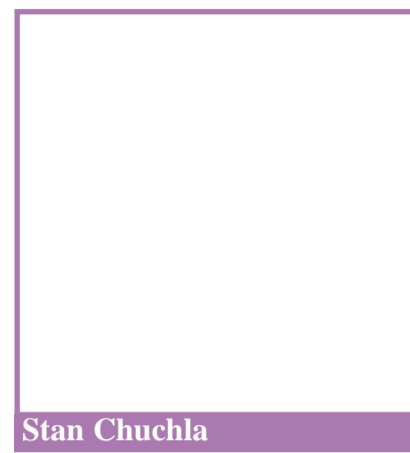
Alan Steel Asset Management was formed in 1975, over 20 years ago.

Now the collective experience of the team in financial planning, personal finance, investment strategies and plans, tax and offshore tax planning and employee benefits amounts to more than 120 years!

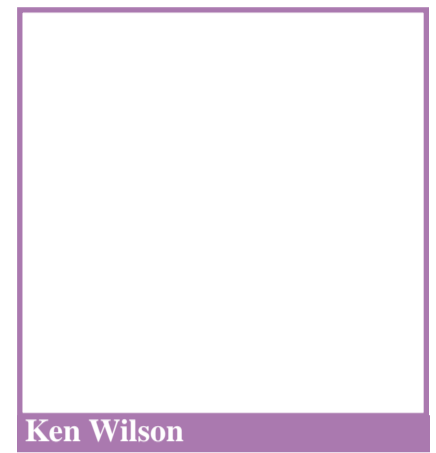
The collective EXPERIENCE of the team amounts to more than 120 years!



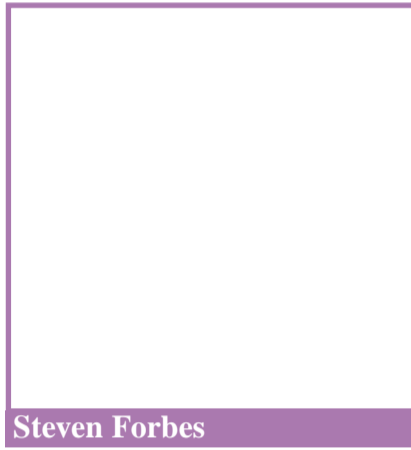
Alan Steel



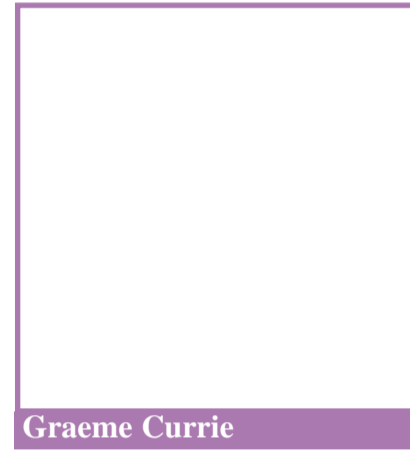
Stan Chuchla



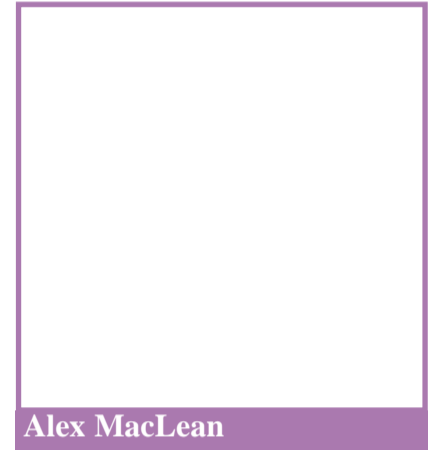
Ken Wilson



Steven Forbes



Graeme Currie



Alex MacLean

What we are today?

These advisers have made Alan Steel Asset Management what it is today:

- A leading firm of independent financial advisers in the UK

Apart from over 9,000 clients, over £250 million under IFA management, 30 staff, six investment and pension advisers and a specialist tax expert, Alan Steel often leads the public debate in the Press on major personal financial issues of concern to clients and the media.

Our success and growth

A LEADING firm of independent financial advisers in the uk

as a business is due firstly to:

- Many of our clients endorsing us and recommending us to their colleagues and friends. A very big thank you to all of them.

Secondly, mentions in

the media and industry awards have all helped build our reputation. Most recently winning the:

- International IFA Administrator of the Year Award 1998 and featuring in:
- Harpers & Queen, (Feb 1998)– the 'A' List of 10 Financial Advisers in the UK.

We believe that these good reports of us stem from our commitment to outstanding client service and to having innovative ideas enabling us to:

- Understand and look after successful people exceptionally well.

Often clients are very busy people without much time to spare for dealing with their own financial affairs or they may just find money decisions a continuing mystery. So we try to:

- Simplify the key issues and explain them clearly to clients.

Many people who are successful in other fields readily admit to not understanding or being particularly interested in financial matters; so we aim to look after them through:

- Our commitment to long term relationships as demonstrated by providing regular valuations, reviews of changing circumstances and being:
- Very good value for money.

which helps us build these client loyalties. Our innovative ideas,

high levels of service and independent advice, that is independent of the insurance companies or fund managers who invest client savings, comes at no extra cost - that is to what it would cost clients to buy the same investment, protection or pension product direct. The margin between offer prices (the price you pay to buy) and bid prices (the price you would receive on selling) on your

investments covers our commission. Hence no extra cost to our clients for our advice and ongoing service. Finally, but most importantly:

- Our enlightened approach to tax planning

when assessing client needs. Many of our competitors ignore tax planning much to client's disadvantage. We aim to create capital for our clients when

they are alive for generating tax free income, in the form of cash down and leaving only income when they die because this approach minimises their tax bills and maximises their wealth. Bear in mind that the UK tax system is designed to tax income when you are living and to tax capital when you die. Our approach reverses this design as far as possible to client's advantage!

Why choose ASAM?

People even with relatively modest means can achieve financial independence with the right advice - and do not have to rely hopelessly on winning the lottery, receiving an inheritance or selling a business!

Our clients need an adviser who can recommend appropriate investment, pension or life protection solutions which match their, and their families' needs, in life and death and of course their resources.

Generally, we find that our clients want:

- Security for their investments
- Simplicity for their financial affairs
- Service from their adviser that is reliable

So OUR PROMISE to our clients is that they will get:

- A simple structure to their affairs, that assesses their needs, tax, savings and risk, protects against inflation and strikes a balance between investing for

the future and protecting wealth.

Therefore WE OFFER clients:

- A fresh independent appraisal of existing investment strategies or start from scratch
- Pension planning organised properly to provide for clients and their families, in retirement or sudden death
- New ways of saving and investing
- To reduce the tax they pay
- To reduce families' exposure to Inheritance Tax
- Long term care protection in the event of ill health, critical illness and death.

If this offer matches your needs, in whole or part, then do contact us. If you are a client already do tell your friends and colleagues about us.

P.S. If you are looking for reassurance that our company is here for the long term, we can do no better than to offer you this analyst's comments for June 1997, the end of our financial year.

"The pattern of financial risk is that of a company with inherent financial strength."— Dr Merv Lincoln, Lincoln Indicators.

- 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.

Services we provide

- 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.

Alan Steel Asset Management is regulated by the Personal Investment Authority. Please remember that the value of your investment and the income from it can go down, as well as up, and you may not get back the amount you originally invested. Past performance is not necessarily a guide to future performance. The information in this newsletter is based on our understanding of current UK tax legislation which may be changed in the near future.